IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-568

OCCIDENTAL LIFE INSURANCE COMPANY OF CALIFORNIA, a Corporation, *Petitioner,*

LHI-688 EMPLOYEES RETIREMENT AND PENSION PLAN TRUST; PHILIP L. GOODWILLING; LEVI SANFORD; ERNST NEIDEL; PAUL AKERS; RONALD GAMACHE; MICHAEL DUNN; KENNETH CARROLL; JAMES JOINER; CHICK THORNTON; and JOHN BECKER

v.

CHARLES SAFFO, RICHARD KAVNER and HAROLD J. GIBBONS, *Respondents.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

CAROLYN PHYLLIS CHIECHI
GEORGE H. BOSTICK
1666 K Street, N.W.
Washington, D.C. 20006

Counsel for Petitioner

WILLIAM B. HARMAN, JR.
FRANCIS M. GREGORY, JR.
SUTHERLAND, ASBILL & BRENNAN
1666 K Street, N.W.
Washington, D.C. 20006

Of Counsel

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

INDEX

	Page
Opinions Below	2
Jurisdiction	2
Questions Presented for Review	2
Statutes Involved	3
Statement of the Case	3
Reasons for Allowance of the Writ and Argument	12
Summary	12
1. The Decision Below Violates the Preemption Provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") and Incorrectly Interprets Those Provisions in a Manner Conflicting With the Decisions of Other Circuits	13
2. The Decision Below Violates Public Policy by Requiring the Payment of Discriminatory Benefits to Former Officers of the Employer Sponsoring the Plan	23
3. Even Under the State Law Incorrectly Applied by the Eighth Circuit, the Decision Below Is Clearly Erroneous	28
4. The Decision Below Is Contrary to Section 302 (c)(2)(A) of ERISA, Section 412(c)(2) of the Internal Revenue Code, and Generally Accepted Actuarial Principles	32
Conclusion	36
Appendices to Petition	
Appendix A—Opinions Below	1a
Order Denying Rehearing	45a
Order Denying Recall of Mandate	46a
Appendix B—Statutes	1b
Regulations	5b

CASES: Page

Allied Structural Steel Co. v. *Spannaus*, 438 U.S. 234 (1978) 13

Amory v. *Boyden Associates*, 434 F. Supp. 671 (S.D. N.Y. 1976) 15

Association of Westinghouse Salaried Employees v. *Westinghouse Electric Corp.*, 348 U.S. 437 (1955) 22 n.10

Cate v. *Blue Cross and Blue Shield of Alabama*, 434 F. Supp. 1187 (E.D. Tenn. 1977) 22 n.10

Cowan v. *Keystone Employee Profit Sharing Fund*, 586 F.2d 888 (1st Cir. 1978) 22 n.10

Erie R.R. Co. v. *Tompkins*, 304 U.S. 64 (1938) 15

Hibernia Bank v. *International Brotherhood of Teamsters*, 411 F. Supp. 478 (N.D. Cal. 1976) 22

Keller v. *Graphic Systems of Akron, Inc., Employees Profitsharing Plan*, 422 F. Supp. 1005 (N.D. Ohio 1976) 15

Malone v. *White Motor Corp.*, 435 U.S. 497 (1978) 13

Morgan v. *Laborers Pension Trust for Northern California*, 433 F. Supp. 518 (N.D. Cal. 1977) 15, 17

Reiherzer v. *Shannon*, 581 F.2d 1266 (7th Cir. 1978) 15, 17

Riley v. *MEBA Pension Trust*, 570 F.2d 406 (2d Cir. 1977) 15, 17, 18

STATUTES:

26 U.S.C. section 401(a)(4), 1976 ed. 3, 4, 23, 25

26 U.S.C. section 412, 1976 ed. 19 n.8, 33

26 U.S.C. section 501(a), 1976 ed. 4

26 U.S.C. section 4971, 1976 ed. 19 n.8

28 U.S.C. section 1254(1), 1976 ed. 2

29 U.S.C. section 1002(21), 1976 ed. 21

29 U.S.C. sections 1003(a) and (b), 1976 ed. 14

29 U.S.C. section 1053, 1976 ed. 14, 25 n.11

Page

29 U.S.C. sections 1081-1086, 1976 ed. 19 n.8, 33

29 U.S.C. sections 1101-1114, 1976 ed. 21

29 U.S.C. sections 1132(d)(1) and (2), 1976 ed. 3, 22

29 U.S.C. sections 1144(a), (b) and (c), 1976 ed. .. 3, 13, 14, 15, 16, 19, 21, 22

29 U.S.C. section 1202(c), 1976 ed. 33

29 U.S.C. section 1342, 1976 ed. 19 n.8

19 U.S.C. section 1344, 1976 ed. 25 n.11

REGULATIONS:

26 C.F.R. section 1.412(c)(2)-1 (proposed), 43 Fed. Reg. 38027 (1978) 33, 34, 35

29 C.F.R. section 2509.75-2 .... 21 n.9

29 C.F.R. section 2509.75-5, Q&A D-1 21

IN THE

Supreme Court of the United States

October Term, 1979

No.

Occidental Life Insurance Company of California, a Corporation, *Petitioner,*

LHI-688 Employees Retirement and Pension Plan Trust; Philip L. Goodwilling; Levi Sanford; Ernst Neidel; Paul Akers; Ronald Gamache; Michael Dunn; Kenneth Carroll; James Joiner; Chick Thornton; and John Becker

v.

Charles Saffo, Richard Kavner and Harold J. Gibbons, *Respondents.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioner, Occidental Life Insurance Company of California ("Occidental"), prays that a writ of certiorari be issued to review the opinion and judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion and judgment of the United States Court of Appeals for the Eighth Circuit, not yet reported, are reprinted in Appendix A, *infra,* pp. 1a to 35a. The unreported opinion of the District Court for the Eastern District of Missouri is also reprinted in Appendix A, *infra,* pp. 36a to 44a.

JURISDICTION

The judgment of the United States Court of Appeals for the Eighth Circuit was entered on June 1, 1979. A petition for rehearing and a suggestion for rehearing en banc timely filed was denied on July 9, 1979 (Appendix A, *infra,* p. 45a). The mandate of the Court of Appeals issued on July 20, 1979. On August 9, 1979, Occidental filed a motion with the Court of Appeals to recall its mandate pending the filing of a petition for certiorari and a final determination of the matter by this Court. The Court of Appeals denied Occidental's motion on August 20, 1979 (Appendix A, *infra,* p. 46a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED FOR REVIEW

1. Whether Federal rather than state law governs claims relating to an employee benefit plan arising during the so-called "gap" period between the effective date of the preemption provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") and the effective dates of various substantive provisions of ERISA.

2. Whether otherwise "vested" benefits under a tax-exempt qualified employee benefit plan may be re-

duced where such a reduction avoids discrimination prohibited by the Internal Revenue Code in favor of officers, shareholders, or highly compensated employees.

3. Whether the decision below is clearly erroneous even under the incorrect state law standard applied by the Court of Appeals.

4. Whether the decision below is inconsistent with ERISA, the Internal Revenue Code, and generally accepted actuarial principles in requiring that a value be assigned to a nonmarketable guarantee conditioned on factors within the control of a third party.

STATUTES INVOLVED

The statutory provisions involved are 26 U.S.C. section 401, 1976 ed., 29 U.S.C. section 1132, 1976 ed., and 29 U.S.C. section 1144, 1976 ed., set forth in Appendix B, *infra,* pp. 1b, 2b, and 3b.

STATEMENT OF THE CASE

Factual Background

Under the provisions of an Agreement and Declaration of Trust executed as of January 1, 1968, the trustees agreed to receive and administer under a single trust employer contributions received under two separate pension plans—Plan A for employees of the St. Louis Labor Health Institute ("LHI")[1] and Plan B for employees of Teamsters Local 688 ("Local 688").

[1] LHI is a nonprofit organization providing medical benefits to union members and is supported by a number of Teamsters locals, including Local 688.

The Internal Revenue Service ("IRS") held in separate determination letters that each plan qualified under section 401(a) of the Internal Revenue Code of 1954 ("the Code"), 26 U.S.C. § 401(a), and that, accordingly, the trust was exempt from Federal income tax under section 501(a) of the Code, 26 U.S.C. § 501(a).

Thereafter, in or about late 1969, respondent Harold J. Gibbons, the Secretary-Treasurer and Chief Executive Officer of Local 688, directed respondent Richard Kavner, his supervisor of fringe benefits, an original trustee of Plan A and Plan B, and then Vice President of Teamsters Local 688, to develop a joint pension program for LHI and Local 688 employees. The objective was to obtain substantially higher benefits for Local 688 employees than those then existing under Plan B. To this end, the trustees held discussions with Occidental. Because Occidental's first proposal would have provided a benefit level almost the same as that under Plan B, the trustees rejected that proposal. Further discussions were held with Occidental as to providing increased benefits for Local 688 employees through funding Plan A and Plan B on a "pooled" basis under which the two plans would be treated as one with the result that contributions from LHI as well as those from Local 688 could be utilized to support benefits for Local 688 employees. Occidental prepared and submitted to the trustees proposed schedules of contribution and benefit levels based on this "pooling" concept. Occidental advised the trustees that if Plans A and B could not be "pooled," the substantially increased benefits which the trustees wanted for Local 688 employees could not be provided without significantly in-

creased contributions from Local 688 to support such benefits.

In 1971, the then trustees decided to increase the maximum retirement benefit for each full-time Local 688 employee from $300 to $1,200 per month and to fund the increased Local 688 benefits by "pooling" Plan A and Plan B. They further decided that the maximum retirement benefit for each full-time LHI employee should remain unchanged at $300 per month.[2] Accordingly, on March 18, 1971, the trustees incorporated the plans into a single plan document, amended them retroactively to January 1, 1968, to reflect, *inter alia,* the "pooled" funding, and executed the funding contract with Occidental premised upon such "pooling."

The 1971 "pooled" pension plan ("LHI-688 Plan") was never actuarially unsound when considered on the "pooled" funding basis intended and agreed upon by the trustees and Occidental. Absent "pooling," however, the Local 688 portion of the LHI-688 Plan was actuarially unsound. The trustees and Occidental never intended the Local 688 contributions standing alone to support fully the increased benefits for Local 688 employees.

The funding contract between Occidental and the plan trustees included, in section 3.7, a conditional guarantee of benefits for certain named employees, including respondents, who were employed by Local 688 on the date of execution of the contract. The guarantee applied only "[i]f the conditions of the Contract are met" to benefits for such named individuals "which shall become payable under the Plan."

---

[2] Prior to 1971, the maximum benefits for both Local 688 and LHI retirees had been $300 per month for 60 months and $110 per month thereafter.

A condition contained in section 7.22 of the funding contract as well as the terms of the LHI-688 Plan and the underlying trust explicitly required the trustees to keep and maintain the plan as a tax-exempt qualified plan under the Internal Revenue Code and the regulations and rulings of the IRS. Accordingly, the trustees applied to the IRS for a determination that the LHI-688 Plan was a tax-exempt qualified plan. The trustees filed separate applications for the LHI and Local 688 portions of the "pooled" plan. However, the trustees informed the IRS in its application that Local 688 would not be providing all of the contributions necessary to provide benefits under the Local 688 portion of the "pooled" plan. The IRS ruled favorably, and the trustees informed Occidental that the IRS granted tax-exempt qualified status to the "pooled" plan.

On January 1, 1972, less than a year after the LHI-688 Plan was adopted and the funding contract was entered into by the trustees, respondent Kavner, an officer of Local 688, retired and began receiving a pension of $1,200 per month. Respondent Gibbons, Local 688's Chief Executive Officer, and respondent Saffo retired in August, 1973, and began receiving pensions of $1,200 and $800 per month, respectively.

In November, 1973, the trustees amended the Local 688 portion of the "pooled" LHI-688 Plan to provide for vesting and early retirement, to increase the break-in-service period, and to reduce the number of years of service required for normal retirement ("Amendment 2"). The trustees considered paying for these changes through increased contributions from Local 688, but rejected that idea because they believed that Local 688 could not afford to increase contributions. Instead, the

trustees decided to pay for the changes by incorporating as part of Amendment 2 a reduction of the monthly pension benefits per year of service for Local 688 employees who retired after December 31, 1973. Amendment 2, which was *prospective* in application and thus would not have affected the retirement benefits of respondents Kavner, Gibbons, and Saffo, was adopted contingent upon an IRS determination that it would not affect adversely the tax-exempt qualified status of the LHI-688 Plan. Thus, the trustees applied to the District Director of Internal Revenue ("District Director") for such a determination. During the course of its consideration of Amendment 2, the District Director's office requested *segregated* financial information for the Local 688 portion of the plan. The financial data submitted showed that LHI contributions were necessary to provide benefits to the Local 688 employees. In other words, the information made clear that the LHI-688 Plan was actuarially sound *only* on a "pooled" basis, the basis upon which the trustees amended Plans A and B in 1971 and the basis intended and agreed upon by the trustees and Occidental as a condition of the funding contract.

In July, 1974, the District Director issued an unfavorable determination to the trustees and, based on the *segregated* financial data submitted, advised the trustees that the Local 688 portion (Plan B) was underfunded. The trustees appealed to the National Office of the IRS the District Director's determination that Amendment 2 would disqualify Plan B (the Local 688 portion of the plan) as a tax-exempt qualified plan under the Internal Revenue Code.

The Commissioner of Internal Revenue ultimately determined in March, 1975, that Amendment 2 would disqualify the plan on the ground that its solely prospective reductions in monthly benefits would constitute discrimination prohibited by section 401(a)(4) of the Internal Revenue Code, since three of the four retirees (including respondents Kavner and Gibbons), whose benefits were not affected by Amendment 2, and who thus would continue to receive significantly higher benefits under the 1971 plan amendment, were former union officers. In this connection, the Memorandum Opinion of the Commissioner of Internal Revenue stated:

> "Two of the three officers of the Employer who retired after the 1971 amendment and before January 1, 1974, are receiving retirement benefits equal to $1,200 per month ($40 per month times 30 years maximum credited service). The third officer's monthly benefit is equal to $840 ($40 per month times 21 years of credited service). If these three employees had retired prior to the 1971 amendment, their monthly retirement benefit would have been only $250, and if the $20-per-month benefit rate with respect to credited service completed after December 31, 1973, applied to them, their monthly benefit would be half what it is now. As it turns out, the $40-per-month rate obtains only during a relatively short period of time and benefits primarily officers of the Employer rather than employees in general.
>
> "Thus, it is our conclusion that the partial termination of the Plan resulting from Amendment No. 2 produced discrimination of the type prohibited by section 401(a)(4) of the Code. In this regard, it is immaterial whether or not there was a valid business reason for the partial termination, and whether or not Plan A and Plan B are treated as one plan or as separate plans."

After the IRS rejected Amendment 2 as discriminatory, the trustees proposed Amendment 4 which contained the *retroactive* benefit reductions giving rise to this action. The trustees proposed Amendment 4 in part because the District Director's office had questioned the financial soundness of the Local 688 portion of the LHI-688 Plan after it had requested and examined during the course of considering Amendment 2 financial data showing the funding of the LHI and Local 688 portions of the plan on a segregated, rather than a "pooled," basis. The view of the District Director's office was that Plans A and B should never have been approved on a "pooled" basis in the first place and that a retroactive segregation of contributions was necessary. The trustees therefore decided that the LHI and Local 688 contributions had to be retroactively segregated and that LHI contributions could not be used to provide benefits for Local 688 employees. The trustees knew, however, that, given the high benefit levels established in 1971, the Local 688 portion of the plan, on a segregated funding basis, was clearly underfunded. In addition, the trustees believed that Local 688 could not afford to increase contributions. The rejection of Amendment 2 by the Internal Revenue Service also eliminated a *solely prospective* benefit reduction as an available option for correcting the underfunding and paying for any plan improvements.

Viewed against this background, the trustees chose the only viable option when they elected to eliminate the underfunding of Local 688 benefits through Amendment 4. That Amendment, which was premised on segregated rather than "pooled" funding, provided for essentially the same plan improvements as Amendment 2 (some of which, such as preretirement vesting, were

required by provisions of ERISA that were scheduled to become effective in 1976) and further provided for a reduction of monthly benefits for all employees, including the monthly retirement benefits of the three respondents herein. Amendment 4 was approved by the IRS in a determination letter dated August 11, 1975, which expressly stated that reduction of future retirement benefits to the retired employees, coupled with the return of excess amounts previously paid to those retirees, would "remove the discriminatory treatment apparent in the first proposed amendment."

Thereafter, on September 9, 1975, the trustees formally adopted Amendment 4 and instructed Occidental to reduce the monthly benefits of respondents Gibbons and Saffo to reflect Amendment 4, including reductions to recoup the excess amounts previously paid to them. The trustees required respondent Kavner to make a lump sum reimbursement of benefits previously paid to him.[3] These benefits were implemented by Occidental and this litigation ensued.

Trial Court Proceedings

Respondents brought suit in February, 1976, in the Circuit Court for the City of St. Louis, State of Missouri, against Occidental, the LHI-688 Plan and its trustees and the officers of Teamsters Local 688. The state proceedings were subsequently removed to and

[3] After the IRS rejected Amendment 2, but before Amendment 4 was adopted, the trustees determined that respondents Kavner and Gibbons had claimed impermissible service dates and therefore corrected their service dates. In addition, the trustees determined that respondent Kavner had incurred a break in service, as defined in the LHI-688 Plan, and was therefore ineligible to receive any pension benefits.

consolidated in the United States District Court for the Eastern District of Missouri. Relying upon Missouri law, the District Court held that the officers, the plan and its trustees, and Occidental had committed breaches of contract by reducing the payments to Gibbons and Saffo and by terminating the payments to Kavner; that Occidental was liable for "actuarial malpractice" and breach of its contract to provide actuarial services by not informing the IRS of the alleged "value" of its conditional guarantee of the plan benefits for certain named Local 688 employees; and that Occidental was liable for fraud, "actuarial malpractice," breach of fiduciary duty, and breach of its contract to provide actuarial services by not informing the trustees that Amendment 4 would reduce its alleged liability on the conditional guarantee. In so holding, the District Court totally ignored Occidental's contention that its funding contract with the plan trustees was conditioned on a "pooling" of Plans A and B and concluded that Occidental had an anticipated actuarial loss of $800,000 in respect of its conditional guarantee at the time it entered into the contract, which increased to $1,067,000 by 1974—a "value" the District Court held Occidental should have assigned to its conditional guarantee in its actuarial reports to the IRS and its dealings with the trustees. (A copy of the unreported Memorandum Opinion of the District Court is included in Appendix A.)

Proceedings in the Court of Appeals

On appeal, the Court of Appeals for the Eighth Circuit applied Missouri law and affirmed the District Court's decision as to the various theories of liability

resulting from the benefit reductions of Amendment 4.[4] District Court Judge Benson, who was sitting by designation, dissented with respect to the holding of liability on the part of Occidental. (A copy of the Court of Appeals' Opinion is included in Appendix A.)

REASONS FOR ALLOWANCE OF THE WRIT AND ARGUMENT

Summary

This case involves questions of the supremacy of Federal law as well as other issues of importance in the administration of employee benefit plans.

First, the holding below violates the Federal preemption provisions of ERISA by applying state law and is in direct conflict with decisions of the Second and Seventh Circuits. The court below, in violation of established Federal common law, substitutes its own judgment for that of plan trustees in making discretionary interpretations of the provisions of an employee benefit plan. It thereby invites the litigation of every determination made by plan trustees and adversely affects the interests of insurers and third parties who must rely on such determinations.

Second, the decision below violates public policy, recognized by both ERISA and the Internal Revenue Code, by requiring the payment of discriminatory bene-

---

[4] The Court of Appeals reversed the District Court and held that Gibbons' benefits should be reduced and Kavner's terminated on the ground that, contrary to the clearly erroneous findings of the District Court, Gibbons and Kavner had committed fraud with respect to their respective service commencement dates and that Kavner had incurred an impermissible break in service which violated the plan's eligibility requirements. Occidental believes the reversal on these issues was proper.

fits to union officers. It encourages union or corporate officers nearing retirement age to inflate plan benefits to artificially high levels by assuring them that, short of complete termination of the plan, their own benefits will not be reduced no matter how costly future funding of those benefits proves to the plan sponsor and, ultimately, to the remaining employees.

Third, in addition to applying the wrong legal standard and reaching a decision contrary to public policy, the court below reaches a result which is clearly erroneous even under state law.

Finally, to comply with the principles embodied in the Eighth Circuit majority opinion that Occidental committed, *inter alia,* fraud and "actuarial malpractice," pension actuaries would be required to violate ERISA, the Internal Revenue Code, and generally accepted actuarial principles.

1. The Decision Below Violates the Preemption Provisions of the Employee Retirement Income Security Act of 1974 and Incorrectly Interprets Those Provisions in a Manner Conflicting With the Decisions of Other Circuits.

As this Court has recognized, Congress preempted all state law relating to employee benefit plan regulation when it enacted the Employee Retirement Income Security Act of 1974.[5] *Allied Structural Steel Co.* v. *Spannaus,* 438 U.S. 234, 248-9, n. 21 (1978); *Malone* v. *White Motor Corp.,* 435 U.S. 497, 499 n. 1 (1978). Section 514(a) of ERISA, 29 U.S.C. § 1144(a), provides in pertinent part:

> '[T]he provisions of this title [the labor law provisions of title 1 of ERISA] and title IV [the

[5] Section 514 of ERISA does contain certain limited statutory exceptions from preemption. Those exceptions are not relevant here.

Pension Benefit Guaranty Corporation provisions of ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b). This section shall take effect on January 1, 1975."[6]

Section 514(c)(1) of ERISA, 29 U.S.C. § 1144(c)(1), defines "State law" to include "all laws, ***decisions***, rules, regulations, ***or other State action*** having the effect of law, of any State." (Emphasis added.) Thus, preemption applies to state common law claims as well as state statutes.

The LHI-688 Plan is unquestionably an employee benefit plan described in section 4(a) of ERISA, 29 U.S.C. § 1003(a), and is not exempt under section 4(b) of ERISA, 29 U.S.C. § 1003(b). The adoption of Amendment 4, the act of which respondents complain and which gave rise to any cause of action they might have, occurred on September 9, 1975. Thus, all of the various claims asserted by respondents with respect to the retroactive benefit reductions of Amendment 4 should have been treated as governed by Federal law.

Despite the plain language of section 514(a) of ERISA, 29 U.S.C. § 1144(a), the court below concluded that pre-ERISA state law governed respondents' causes of action. The basis for the Eighth Circuit's conclusion was that the vesting provisions of section 203 of ERISA, 29 U.S.C. § 1053, did not take effect until January 1, 1976, and that, even though sec-

---

[6] The effective date of ERISA preemption is further elaborated in section 514(b)(1) of ERISA, 29 U.S.C. § 1144(b)(1):

> "This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975."

tion 514 of ERISA, 29 U.S.C. §1144, took effect on January 1, 1975, state law, in this case Missouri law, applied during this "gap" period.[7] (Appendix A, p. 22a, n.22.) The Court of Appeals' determination that state law rather than Federal law applies to causes of action which arose during the "gap" period is erroneous and conflicts with the explicit holdings of the Second Circuit in *Riley* v. *MEBA Pension Trust,* 570 F.2d 406 (2d Cir. 1977), of the Seventh Circuit in *Reiherzer* v. *Shannon,* 581 F.2d 1266 (7th Cir. 1978), and of two District Courts, *Morgan* v. *Laborers Pension Trust for Northern California,* 433 F. Supp. 518 (N.D. Cal. 1977) and *Amory* v. *Boyden Associates,* 434 F. Supp. 671 (S.D. N.Y. 1976). Although there are differences in the reasoning employed in these cases, they are unanimous in their conclusion that Federal law applies during the "gap" period.

Rather than following any of those decisions, however, the court below followed *Keller* v. *Graphic Systems of Akron, Inc.,* 422 F. Supp. 1005 (N.D. Ohio 1976), a District Court decision which reaches its conclusion that state law applies by improperly analyzing *Erie R.R. Co.* v. *Tompkins,* 304 U.S. 64 (1938). Consequently, instead of concluding, as it should have, that all of the claims asserted by respondents were preempted by ERISA, the Eighth Circuit proceeded to apply state law to each of those claims.

---

[7] The Eighth Circuit's rationale suggests that its misanalysis of the preemption issue may extend beyond the "gap" period. At base, the decision appears to hold that state law is preempted only where it conflicts with an effective substantive provision of ERISA. This type of "conflict" preemption was considered and rejected by Congress in favor of the "total field" preemption contained in section 514 of ERISA, 29 U.S.C. § 1144.

The principal theory on which Occidental was held liable below was that under Missouri law Occidental, in 1975, breached the terms of its funding contract with the plan trustees—a contract of which the respondents were, according to the court below, third party beneficiaries (Appendix A, p. 12a, n.13)—by reducing payments to respondents pursuant to the instructions of those trustees and Amendment 4 to the plan. This state law breach of contract claim clearly "relate[s] to" an "employee benefit plan" within the meaning of section 514(a) of ERISA, 29 U.S.C. § 1144(a), and is therefore preempted by that section. Accordingly, the determination of liability under state law based on this pre-ERISA cause of action should be reversed by this Court.

In addition to the fact that respondents' breach of contract claim against Occidental was preempted, any conceivable liability of Occidental to respondents flowing from the *funding contract* between Occidental and the trustees must necessarily be premised on the trustees' alleged breach of the *plan*. Occidental reduced payments to respondents under its contract with the trustees in accordance with instructions received from the trustees and in accordance with Amendment 4 to the plan. It is indisputable that the propriety of the action of the trustees in amending the plan is, under the preemption provisions (section 514) of ERISA, 29 U.S.C. § 1144, to be ascertained under Federal law rather than under the Missouri common law applied by the court below. Logically, if Amendment 4 was, under Federal law, a proper exercise of the discretion granted the trustees to amend the plan, then Occidental —whose contract was, after all, a contract with the trustees to provide benefits pursuant to the plan—

could not conceivably have any contractural obligation to respondents as third party beneficiaries to pay the unreduced benefits.

In determining whether the trustees acted properly in adopting, during the so-called "gap" period, a plan amendment retroactively reducing benefits, the applicable Federal standard is whether such action was "arbitrary or capricious." *Riley* v. *MEBA Pension Trust, supra.* The Second Circuit there addressed the plaintiff-appellant's claim that during the "gap" period he had been improperly denied "vested" pension benefits. Judge Friendly, speaking on behalf of the panel, concluded that, even though denial of the benefits would be improper under the subsequently effective vesting provisions of ERISA, the "arbitrary or capricious" standard applied during the "gap" period and, under this standard, the denial was not improper. 570 F.2d at 411-13. *See also Reiherzer* v. *Shannon, supra; Morgan* v. *Laborers Pension Trust Fund for Northern California, supra.*

Riley is particularly instructive here in that the Second Circuit, unlike the Eighth Circuit, properly distinguished the role of a court when faced with the interpretation of a statute from its role in interpreting the provisions of a pension plan in circumstances where plan trustees have been given discretion to interpret the plan. After quoting the provision of the *Riley* plan giving the plan trustees the power to construe the plan, Judge Friendly correctly noted:

> "When such power has been conferred, the judicial role is limited to determining whether the trustees' interpretation was made rationally and in good faith—not whether it was right. [Citations omitted.] With respect to § 203(a)(3)(B)(ii),

> however, the question . . . is what Congress meant, not what the Plan meant, and we must treat this as we would any other question of statutory construction." 570 F.2d at 410.

Like the plan in *Riley,* the LHI-688 Plan contains a provision giving the trustees power to interpret the plan. That provision, the second paragraph of section 9.1, states:

> *Decision of Trustees.* Except where the power of determination is expressly reserved to the Employer or the Insurance Company, the Trustees will have full power and authority to determine all matters arising in the administration, interpretation and application of the Plan, and the determination of any such matter by the Trustees will be conclusive on all persons. In the event of a deadlock on the part of the Trustees in any matters, such deadlock shall be broken as provided in the Trust Agreement, and the decision shall be final and binding. Any rules and regulations and any exercise of discretion or other action by the Trustees will be equitable and non-discriminatory and will be uniform in application as between Participants.

The majority below makes no mention of this provision but instead proceeds as if it were, in fact, interpreting a statute. In response to the argument that "the trial court erred in determining that the trustees acted in violation of the plan and the trust agreement when, in accordance with Amendment 4, they directed Occidental to change payments to the retirees," the majority opinion states:

> "The trustees and officers contend that the retirees' pension rights are merely contractual and

are governed by the terms of the plan documents. Since Plan B allowed the trustees to amend it, the retirees' rights could be adversely affected at a later date, provided that the trustees acted reasonably and in a manner consistent with the purposes of the trust agreement and the plan. When the IRS disqualified the plan and found it to be severely underfunded, the trustees were confronted with a situation that endangered the plan's survival. Under the circumstances, they argue it was appropriate and reasonable for them to adopt Amendment 4, and that their judgment should not be overturned by the trial court.

"We disagree with the analysis of the trustees and officers. The retirees' pension rights are not as amorphous as they suggest." Appendix A, pp. 21a-22a. (Emphasis added.)

Having thus rejected the trustees' contention that the question before the Eighth Circuit was whether the trustees' decision was "arbitrary or capricious," and not whether it was *right,* the majority opinion, in clear violation of section 514 of ERISA, 29 U.S.C. § 1144, launches immediately into its analysis of preempted state law.

Asking the *wrong question* naturally elicited the *wrong answer.* Had the majority below properly framed the question as whether the trustees acted "arbitrarily or capriciously" in adopting the retroactive benefit reductions contained in Amendment 4, the answer would have to have been that they did not. In view of the situation confronting them, it simply cannot be said that the action of the trustees in adopting the only realistic alternative open to them—reducing benefits retroactively—was "arbitrary or capricious." [8]

[8] The trustees believed that, even disregarding the cost of desired plan improvements and ERISA required changes, the plan was

Although breach of contract by reducing respondents benefits was the principal theory on which the court below held Occidental liable to respondents, it was not the only theory. The court also affirmed, without analysis, the District Court's holdings that Occidential was liable on theories of "actuarial malpractice," breach of contract to provide actuarial services, fraud, and breach of fiduciary duty. Though neither the Eighth Circuit nor the District Court explicitly held that state

---

underfunded with respect to the high Local 688 benefits and would continue to be underfunded absent some alteration in the plan. See pp. 9-10, *supra*. The minimum funding standards of ERISA, sections 301-306, 29 U.S.C. §§ 1081-1086 and section 412 of the Internal Revenue Code, 26 U.S.C. § 412, were to become effective with respect to the plan in 1976. Failure to meet these standards would have subjected Local 688 to a potential 100 percent excise tax on the "accumulated funding deficiency" under section 4971 of the Internal Revenue Code, 26 U.S.C. § 4971. Such failure would also have resulted in a possible involuntary termination of the plan by the Pension Benefit Guaranty Corporation under section 4042 of ERISA, 29 U.S.C. § 1342. The underfunding of the Local 688 portion of the plan had to be corrected, but Local 688 could not afford to increase contributions above the already substantial level of $40 per week per employee. Moreover, in view of the prior rejection of Amendment 2 by the Internal Revenue Service, elimination of the underfunding through a solely prospective benefit reduction was not an available option. Finally, it should also be borne in mind that, because of the joint nature of the LHI-688 Plan, the trustees owed an obligation to the LHI participants as well as to the Local 688 participants. Thus, even had the IRS not required them to do so, the trustees who were administering the LHI-688 Plan in 1975 might reasonably have concluded that the "pooling" of LHI and Local 688 contributions under the 1971 amendment in order to provide a $1,200 per month maximum benefit for Local 688 employees, while maintaining only a $300 per month maximum benefit for LHI employees, was not consistent with what they viewed as their duty to the LHI participants.

law governed these claims, it is clear that something other than Federal law was applied. These state law causes of action having been preempted by section 514 of ERISA, 29 U.S.C. § 1144, liability premised on them cannot be sustained.

Each of these theories is predicated on Occidental's alleged failure to disclose to the trustees its purported liability under the conditional "guarantee" contained in section 3.7 of the funding contract. The closest analogy to these state law theories under ERISA would seem to be an allegation that Occidental violated the fiduciary responsibility provisions of sections 401-414 of ERISA, 29 U.S.C. §§ 1101-1114. However, under the definition in section 3(21) of ERISA, 29 U.S.C. § 1002 (21), Occidental was not an ERISA fiduciary because it did not possess any discretionary authority, control, or responsibility over the management or administration of the plan.[9] Nor were its actuaries fiduciaries of the plan. The relevant Department of Labor regulation, 29 C.F.R. § 2509.75-5, Q&A D-1, states that "attorneys, accountants, actuaries and consultants performing their usual professional functions will ordinarily not be considered fiduciaries." Because Occidental was not a fiduciary under ERISA, it can have no liability under ERISA's fiduciary responsibility provisions. Because ERISA preempts the state law theories of "actuarial malpractice," breach of contract to provide actuarial services, fraud, and breach of state law fidu-

[9] The portions of section 3(21) of ERISA, 29 U.S.C. § 1002(21), relating to plan assets are not apposite here. The funds held by Occidental under the contract were held in its general asset account and, therefore, are not treated as plan assets. See 29 C.F.R. § 2509.75-2.

ciary duty as those theories relate to employee benefit plans, Occidental can have no liability under those theories. *Cf. Hibernia Bank* v. *International Brotherhood of Teamsters,* 411 F. Supp. 478 (N.D. Cal. 1976).

No matter how this case is viewed, one inevitable conclusion is that no liability of Occidental has been established under ERISA. In view of this conclusion, the District Court, whose jurisdiction was premised on section 502 of ERISA, 29 U.S.C. § 1132, did not have power to enter a judgment against Occidental. Section 502(d)(2) of ERISA, 29 U.S.C. § 1132(d)(2), provides:

> "Any money judgment under this title against an employee benefit plan shall be enforceable only against the plan as an entity and shall not be enforceable against any other person unless liability against such person is established in his individual capacity *under this title.* (Emphasis added.)

The court below, by disregarding the preemption provisions of section 514 of ERISA, 29 U.S.C. § 1144, found Occidental liable under state law. Whether Occidental has any liability to respondents under ERISA was never addressed. Absent a finding of ERISA liability, the court was without authority to direct that a judgment be entered requiring Occidental to make payments to respondents.[10]

---

[10] Even disregarding the preemption provisions of section 514 of ERISA, 29 U.S.C. § 1144, it should have been apparent to the court below that respondents' claims could not have been, as the court assumed they were, governed by state law. The requirements for diversity jurisdiction were not satisfied in this case. Instead, Federal jurisdiction was premised on section 502 of ERISA. *If* the court below was correct in applying state law to respondents' claims, then this case properly belonged in state court because either the

2. The Decision Below Violates Public Policy by Requiring the Payment of Discriminatory Benefits to Former Officers of the Employer Sponsoring the Plan.

Section 401(a)(4) of the Internal Revenue Code requires that benefits provided by a tax-exempt qualified pension plan *not* discriminate in favor of officers, shareholders, or highly compensated employees (the so-called "prohibited group"). The purpose of this provision is to prevent an employer from providing retirement benefits for its management employees without also providing equivalent benefits for its rank and file employees. This antidiscrimination requirement can be violated by changes in a plan's benefit structure over time as well as by more obvious differentials in benefits in effect at a given time. Thus, where a benefit increase is in effect for only a short period, and during that period members of the prohibited group benefit disproportionately from the increase, prohibited discrimination results.

When the 1971 plan amendments were adopted by the trustees and increased substantially the benefits for Local 688 employees, respondent Harold J. Gibbons was the Chief Executive Officer and Secretary-Treasurer of Teamsters Local 688 and respondent Richard Kavner was Vice President of Local 688, a trustee of Plan A and Plan B, and Gibbons' supervisor of fringe benefits. Less than a year after the 1971 amendments,

---

statutory requirements for jurisdiction under section 502 of ERISA or the constitutional requirements for "federal question" jurisdiction were not satisfied. *Cf. Association of Westinghouse Salaried Employees* v. *Westinghouse Electric Corp.*, 348 U.S. 437, 442 (1955); *Cowan* v. *Keystone Employee Profit Sharing Fund*, 586 F.2d 888 (1st Cir. 1978); *Cate* v. *Blue Cross and Blue Shield of Alabama*, 434 F. Supp. 1187 (E.D. Tenn. 1977).

officer Kavner retired and began to receive the maximum benefit. In 1973, officer Gibbons retired and began to receive the maximum benefit.

In November, 1973, shortly after these former officers began receiving the inflated benefits they had established in 1971, the trustees adopted Amendment 2 which reduced the monthly pension benefits per year of service for Local 688 employees retiring after December 31, 1973. Amendment 2 was adopted contingent upon an IRS determination that it would not affect adversely the tax-exempt qualified status of the LHI-688 Plan.

Because the benefit reductions contained in Amendment 2 were *prospective only* and thus did not affect the retirement benefits of officers Kavner and Gibbons, Amendment 2 violated the antidiscrimination requirements of section 401(a)(4) of the Internal Revenue Code. Accordingly, the District Director and, ultimately on administrative appeal, the Commissioner of Internal Revenue held that these *prospective* reductions would, if implemented, disqualify the plan. See pp. 7-8, *supra*.

The trustees subsequently proposed Amendment 4, which the IRS approved in a determination letter in which it specifically held that if the "excess" amounts already paid to retired employees were recouped, Amendment 4 would not result in the prohibited discrimination which caused the IRS to reject Amendment 2. See pp. 9-10, *supra*.

The net effect of the decision of the Court of Appeals is to require Amendment 4, which was adopted by the trustees with Internal Revenue Service approval, to

be applied to reduce retirement benefits on a *prospective basis only,* thereby producing discrimination identical to that which the Internal Revenue Service sought to prevent in rejecting Amendment 2.

In requiring the plan to discriminate in favor of former officers, the court below clearly violated not only the public policy against such discrimination embodied in section 401(a)(4) of the Internal Revenue Code but also the coordinate principle, recognized even under ERISA's stringent vesting rules, that vested benefits may be retroactively reduced in order to avoid discrimination in favor of the prohibited group.[11] The justification for disregarding public policy and ordering the payment of discriminatory benefits offered by the majority opinion is an assertion that the retroactive benefit reductions of Amendment 4 were not "required" by the IRS to prevent plan disqualification under the Internal Revenue Code. To support this view, the majority states that no letter from the IRS said the plan would be disqualified unless the trustees reduced the retirees' benefits. This reasoning demon-

---

[11] Section 203 of ERISA explicitly states that its otherwise applicable vesting requirements:

> "shall not apply to benefits which may not be provided for designated employees in the event of early termination of the plan under provisions of the plan adopted pursuant to regulations prescribed by the Secretary of the Treasury to preclude the discrimination prohibited by section 401(a)(4) of [the Internal Revenue Code of 1954]." ERISA section 203(c)(2), 29 U.S.C. § 1053(c)(2).

Similarly, section 4044 of ERISA, 29 U.S.C. § 1344, a Pension Benefit Guaranty Corporation provision which establishes priorities for the allocation of plan assets upon plan termination, both implicitly, in its subsections (a)(3) and (a)(4), and explicitly, in its subsection (b)(4), recognizes that assets may be reallocated (*i.e.,* benefits may be reduced) where necessary to avoid discrimination which would disqualify the plan.

strates a total lack of understanding of the manner in which the IRS administers the tax qualification rules of the Internal Revenue Code in respect of employee pension plans. The Internal Revenue Service does not "require," in the very narrow sense apparently contemplated by the majority, a pension plan to do anything to obtain or maintain tax-exempt qualified status. Rather the plan qualification process is basically one which operates through fear of disqualification on audit and in which the burden of maintaining tax qualified status is on the plan rather than on the IRS. Under this scheme, the IRS never has occasion to write letters to plan trustees, which state: "Unless your plan does X, it will be disqualified."[12] Thus, the majority's reading of "required" is wooden and inflexible at best.

Because the burden of maintaining qualification was on the trustees, *they* had the responsibility (and the power, under section 9.1 of the plan, discussed *supra,* at p. 18) to determine what was "required" to maintain the plan's tax-exempt qualified status. The trustees could have corrected the underfunding of the Local 688 portion of the plan, as well as made ERISA required and other desired improvements to the plan, *only* by either substantially increasing contributions or reducing benefits. Local 688 was already contributing $40 per participant per week and could not afford increased contributions. Benefit reduction was the only realistic alternative. The IRS had previously held that

[12] After an application has been filed, the IRS issues a determination letter, stating that a new plan or an amendment to an old plan is or is not in compliance with the tax qualification rules of the Internal Revenue Code. The IRS also audits employee plans. If, on audit, the IRS finds that a plan does not meet the tax qualification rules, it disqualifies the plan retroactively.

Amendment 2's solely prospective reduction in benefits was discriminatory and impermissible. A retroactive reduction of benefits was thus "required" by the circumstances.

Whatever construction is given to the word "required," to admit the truth of the majority's statement that the correspondence from the IRS did not state that the plan would be disqualified "unless the trustees reduced the retirees' pension benefits" (Appendix A, p. 24a) is to admit nothing more than the obvious fact that discriminatory treatment can always be cured by raising the disadvantaged parties to the same level as those favored by the discrimination rather than by cutting back the excessive benefits enjoyed by the favored group.[13] In a world of finite resources, the former approach is sometimes not feasible and the latter approach must be employed. The majority opinion appears to hold, however, that discrimination in a pension plan must always be cured by the former approach. Unless reversed, the decision below offers plans saddled with high pensions calculated to benefit members of the "prohibited group" the dubious choice of potential bankruptcy from increased costs, potential disqualification from solely prospective benefit reduc-

---

[13] The majority below suggests that the plan and the inflated 1971 amendment benefits for Teamsters Local 688 employees could simply have continued in effect unaltered. What the majority totally disregards is that, at the time the trustees were developing Amendment 4 in 1975, they had concluded, based on discussions with the IRS, that LHI contributions had to be segregated totally and retroactively from Local 688 contributions and that LHI contributions could not be used to provide benefits to Local 688 employees. The trustees were keenly aware that the Local 688 portion of the plan was underfunded with respect to the high Local 688 benefits and, unless they modified the plan in some way, would continue to be underfunded. See note 8, *supra*.

tions, or plan termination. Each of these alternatives adversely affects the remaining employees.

If the decision below were not interpreted to produce this result, but instead were interpreted to allow continued tax qualification of the plan without a return to pre-Amendment 4 benefit levels for all employees, the antidiscrimination requirements for qualified plans would become meaningless. Thus construed, the decision would allow officers, shareholders, or highly paid individuals to avoid directly, by contractual bootstrapping, the application of the antidiscrimination requirements, thereby undermining the public policy embodied in those requirements of encouraging the provision of adequate pension benefits for rank and file employees. Under any construction, the decision below precludes use of the most logical and equitable approach of retroactively reducing the artificially inflated benefits of members of the "prohibited group" in order to comply with the antidiscrimination requirements.

3. Even Under the State Law Incorrectly Applied by the Eighth Circuit, the Decision Below Is Clearly Erroneous.

The net effect of the Court of Appeals' application of state law is to permit, contrary to Federal law and public policy, the payment of discriminatory, inflated pension benefits to former officers of Teamsters Local 688. Moreover, the majority compounds error by reaching a result which is indefensible even under state law.

Throughout this case, Occidental has consistently maintained that (1) the conditional guarantee contained in section 3.7 of its funding contract with the trustees was conditioned on, among other things, "pooling" of plan contributions and liabilities for LHI and

Local 688 employees (*i.e.,* treating the LHI plan and the Local 688 plan as a single plan), and (2) when considered on a "pooled" basis, the plan was actuarially sound (*i.e.,* there was no underfunding of benefits for LHI or Local 688 employees). As the dissenting opinion below notes, *all* of the theories on which Occidental was held liable by the Court of Appeals depend upon the acceptance or rejection of these contentions.[14]

The District Court made no finding as to whether "pooling" was a condition of the guarantee in section 3.7 of the funding contract. Rather, in its Findings of Fact No. 5, it simply stated that the "688 pension plan" had never been actuarially sound and explained its finding in terms of the absence of a reasonable likelihood that the Local 688 contributions would ever be sufficient to support the pensions of Local 688 retirees. It then concluded that by virtue of this lack of actuarial soundness Occidental had incurred a liability of $1,067,000 under its guarantee. In short, the District Court simply *ignored* whether "pooling" was a condition of the guarantee and whether the plan was actuarially sound on a "pooled" basis.

---

[14] Assuming that the guarantee is conditioned on "pooling," Occidental cannot be liable to the respondents for breach of contract, on third party beneficiary principles, because the trustees' direction to Occidental to segregate the funds violated that condition, and thus rendered the guarantee void. The remaining theories of liability—"actuarial malpractice," breach of contract to provide actuarial services, fraud, and breach of fiduciary duty—are premised on Occidental's alleged failure to disclose to the IRS and to the trustees the purported $800,000 to $1,067,000 "value" of its guarantee. Assuming "pooling" is a condition of the guarantee, however, there was no "value" to disclose: after the funds were segregated, the guarantee was void; before the funds were segregated, the guarantee was in effect, but since, on a "pooled" basis, the plan was actuarially sound, the guarantee had a zero value.

Although the Court of Appeals, unlike the District Court, addressed the "pooling" issues, the majority opinion's analysis of those issues is illogical and clearly erroneous. That opinion, in the text at footnote 15 and in footnote 15 itself, recognizes that "pooling" was contemplated and intended by Occidental and the trustees, the parties to the contract. However, the majority opinion then concludes that "pooling" was not an "essential element of the contract." In short, the majority, unable to conclude on the basis of the findings and evidence before it that "pooling" was not a condition of the guarantee, decided that, if "pooling" was a condition, it was an immaterial one. Its only basis for this assertion is its own finding that benefits were greater and contributions were less under the final contract provisions respecting the LHI portion of the plan than under an earlier "segregated funding" proposal made by Occidental, which was never accepted. Even assuming the majority's factual finding to be correct, its conclusion that "pooling" was not essential to the conditional contract guarantee simply does not follow. Apparently, it never occurred to the Eighth Circuit majority that changes in actuarial assumptions *other than* "pooling" could have accounted for differences between the proposal and the final contract for the LHI portion of the plan. In fact, this was the case.

The comparison of earlier and later contract proposals on which the majority rests its analysis of the "pooling" issues is simplistic and leads to an incorrect conclusion. The proper question in determining whether "pooling" was an essential concept with respect to the section 3.7 guarantee is whether "pooling" makes a difference in the actuarial soundness of the Local 688 portion of the plan as finally adopted. The

majority (unlike the dissent) never addresses this question. The majority held and Occidental concedes, as it always has, that without "pooling" the Local 688 benefits were severely underfunded. On the other hand, in the words of the dissenting Judge, "It is undisputed that the LHI-688 Plan was never actuarially unsound when considered as a pooled fund." (Appendix A, p. 32a.)

The guarantee in section 3.7 of the contract was a conditional guarantee of the actuarial soundness of the fund (*i.e.,* Occidental guaranteed the ability of the fund to provide the promised benefits provided the conditions of the guarantee were satisfied). The Local 688 portion of the plan was actuarially sound on a "pooled" basis but not on a segregated funding basis. Clearly, therefore, "pooling" was an "essential element" of the guarantee in the funding contract. The majority opinion of the Eighth Circuit holding to the contrary rests entirely on a *non sequitur.*[15]

---

[15] The majority's conclusion that "pooling" was not a material element of the contract also had an impact on its approach to the District Court's findings that Occidental was liable on theories of "actuarial malpractice," breach of its contract to provide actuarial services, fraud, and breach of its fiduciary duty. The majority discussed Occidental's arguments with respect to these theories in a total of two sentences:

> "It [Occidental] contends that these findings are clearly erroneous, reiterating many of the arguments it made with respect to the guarantee. We have carefully examined these arguments and find them to be without merit." Appendix A, pp. 20a-21a.

A conclusion that Occidental was liable under these theories necessarily requires a conclusion that Occidental either *knowingly* or *negligently* failed to supply accurate actuarial data to the IRS and the trustees. Thus, if—as it did—Occidental reasonably believed that its guarantee was conditioned on "pooling," and if—as is undisputed and was in fact the case—on a "pooled" basis the LHI-

4. The Majority Opinion Is Contrary to Section 302(c)(2)(A) of ERISA, Section 412(c)(2) of the Internal Revenue Code, and Generally Accepted Actuarial Principles.

The decision below holds Occidental liable on the novel theory of "actuarial malpractice," as well as on grounds of breach of contract to provide actuarial services, fraud, and breach of fiduciary duty for not assigning and disclosing to the plan trustees and reporting to the IRS the alleged "value" of its conditional contractual guarantee. As discussed above (pp. 28-31), the guarantee was conditioned on "pooling" and thus the guarantee had an actuarial value of zero. Assuming for purposes of argument that the guarantee was not conditioned on "pooling," not assigning a value to it was still proper actuarial practice.

"Actuarial malpractice" and the other theories noted above logically depend on the trial court's finding, upheld by the Court of Appeals, that Occidental's conditional guarantee should have been assigned a value of $1,067,000 for actuarial purposes. To assign any value to this nonmarketable, conditional guarantee is to assume that the plan will remain in existence and the conditions of the guarantee will continue to be met. Among these conditions are the continued receipt of contributions in specified amounts from the plan and the continued tax qualification of the plan. These are matters within the control of the trustees and are therefore outside the realm of actuarial valuations. Thus, not assigning a value to such a guarantee is

688 Plan was actuarially sound (with the result that Occidental reasonably believed that the guarantee never had a "value" greater than zero), Occidental could not be liable under these theories. And this would still be the case even if a court concluded that, despite Occidental's reasonable belief to the contrary, the guarantee was not conditioned upon "pooling."

entirely consistent with commonly accepted actuarial practice.

Assigning a value to the *nonmarketable, conditional* guarantee provided in section 3.7 of the funding contract is inconsistent with provisions of ERISA and of the Internal Revenue Code which recognize and adopt accepted actuarial principles. Section 302(c)(2)(A) of ERISA, 29 U.S.C. § 1082(c)(2)(A), and section 412(c)(2)(A) of the Internal Revenue Code, 26 U.S.C. § 412(c)(2)(A), which are identical in their requirements for valuing plan assets for purposes of determining whether the minimum funding standards of section 302 of ERISA and section 412 of the Internal Revenue Code are satisfied, provide:

> "[T]he value of the plan's assets shall be determined on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under regulations prescribed by the Secretary of the Treasury."

The proposed regulations on "reasonable actuarial methods" for determining whether a plan is adequately funded explicitly recognize that not assigning a value of $1,067,000 (or any other amount greater than zero) to the guarantee of section 3.7 of the contract was entirely reasonable and appropriate. These proposed regulations, although issued by the Department of the Treasury as an interpretation of section 412 of the Internal Revenue Code, also are treated under section 3002(c) of ERISA, 29 U.S.C. § 1202(c), as an interpretation of section 302(c)(2)(A) of ERISA.

The proposed regulations (26 C.F.R. § 1.412(c)(2)-1, reprinted in Appendix B, pp. 5b-14b), which are entitled "Valuation of plan assets; reasonable actu-

arial valuation methods," include specific rules for valuing insurance agreements and provide that, "If an insurer has a *legally enforceable obligation* to provide plan benefits to specific plan participants or their beneficiaries, the plan must on a consistent basis apply" (emphasis added), one of three essentially equivalent methods specified in subsection (c)(3) of the proposed regulations. The proposed regulations then state that such a "legally enforceable obligation" exists if "the insurer is obligated to provide such benefits without further obligation by the plan to pay any consideration for the benefits." Proposed Treas. Regs. § 1.412(c)(2)-1(c)(3)(i). It is undisputed here that one of the conditions of the guarantee in section 3.7 of the contract is continued receipt by Occidental of contributions from LHI and Local 688: if the contributions stop before the expiration of 25 years, so do any benefit payments being made under the guarantee. Accordingly, Occidental has no "legally enforceable obligation" and thus this subsection of the proposed regulations is inapposite.

Even assuming *arguendo* Occidental's guarantee to be a "legally enforceable obligation" within the meaning of the proposed regulations, their provisions plainly indicate that the guarantee involved here could properly have been given a zero value. Subsection (c)(3)(iv) specifies:

> "The plan may include in the fair market value of its assets the obligation's cancellation value. For purposes of this paragraph (c), the term 'cancellation value' means the sum of funds which would be received by the plan if the agreement were terminated on the valuation date."

Neither the respondents nor the court below contests the fact that, under the clear terms of the "guarantee"

provision itself, the only funds which the trustees would have received on termination of the contract during any of the periods involved here were those in the contract's Deposit Fund. No additional funds would have been payable under the guarantee.[16] Thus, the "cancellation value" of the guarantee was zero.

Similarly, under subsection (c)(4) of the proposed regulations, the subsection dealing with valuation of insurance agreements other than those containing a "legally enforceable obligation to pay benefits," the amount to be included as a plan asset is the "account balance" computed under the contract providing for the holding of the deposit fund by the insurance company. Under this subsection, the value of plan assets again would include only the amount of the Deposit Fund held by Occidental, and the conditional guarantee would be disregarded.[17]

Thus, the decision below leads to incongruous consequences. An actuary who, in order to avoid "actuarial malpractice," followed the requirements of the decision below and assigned a value to a conditional guarantee of the sort involved here would be acting in violation of provisions of substantive labor law and the Internal Revenue Code as well as accepted actuarial principles.

---

[16] In fact, in the event of cancellation, any actuarial loss incurred by Occidental under its guarantee would have been offset, under the clear provisions of section 6.7(c)(2)(ii) of the contract, against the Deposit Fund.

[17] It also is significant that the guarantee provided here is, from an actuarial standpoint, similar to the guarantees provided by the Pension Benefit Guaranty Corporation ("PBGC") for plans whose liabilities exceed their assets on termination. The proposed regulations, at section 1.412(c)(2)-1(c)(5), expressly provide that PBGC insurance is *not* to be considered a plan asset.

CONCLUSION

The decision below violates the Federal preemption provisions of ERISA, directly conflicts with decisions of the Second and Seventh Circuits as to the meaning of those provisions, and, in violation of established Federal common law, substitutes the court's interpretation of the employee benefit plan for that of the plan trustees. The Eighth Circuit's decision also violates the Internal Revenue Code and public policy by requiring the payment of discriminatory benefits to former union officers, is clearly erroneous even under the incorrect state law standard applied, and is inconsistent with generally accepted actuarial principles embodied in ERISA and the Internal Revenue Code. For all of the foregoing reasons, it is respectfully requested that this Court issue a writ of certiorari to the United States Court of Appeals for the Eighth Circuit for purposes of reviewing the opinion and decision of that court.

Respectfully submitted,

CAROLYN PHYLLIS CHIECHI

GEORGE H. BOSTICK
1666 K Street, N.W.
Washington, D.C. 20006
(202) 872-7800

Counsel for Petitioner

WILLIAM B. HARMAN, JR.
FRANCIS M. GREGORY, JR.
SUTHERLAND, ASBILL & BRENNAN
1666 K Street, N.W.
Washington, D.C. 20006

Of Counsel

APPENDIX A

Opinions Below

UNITED STATES COURT OF APPEALS
EIGHTH CIRCUIT

Nos. 78-1634 and 78-1638

CHARLES SAFFO, RICHARD KAVNER AND
HAROLD J. GIBBONS, *Appellees,*

v.

OCCIDENTAL LIFE INSURANCE COMPANY OF
CALIFORNIA, A CORPORATION

LHI-688 EMPLOYERS RETIREMENT AND PENSION PLAN TRUST; PHILIP L. GOODWILLING; LEVI SANFORD; ERNST NEIDELL; PAUL AKERS; RONALD GAMACHE; MICHAEL DUNN; KENNETH CARROLL; JAMES JOINER; CHICK THORNTON; AND JOHN BECKER, *Appellants*

Appeal from the United States District Court for the Eastern District of Missouri

Submitted: February 14, 1979

Filed: June 1, 1979

Before HEANEY and MCMILLAN, Circuit Judges, and BENSON,* Chief Judge.

HEANEY, Circuit Judge.

Charles Saffo, Richard Kavner and Harold J. Gibbons, retired beneficiaries of the LHI-688 Employees Retirement and Pension Plan Trust, brought this action against the trustees of the Plan, the officers of Teamsters Local Union

---

* PAUL BENSON, Chief Judge, United States District Court for the District of North Dakota, sitting by designation.

No. 688,[1] and Occidental Life Insurance Company of California, alleging that their pension benefits were unlawfully curtailed or terminated. After a nonjury trial, the trial court found in favor of the appellees on the substantive issues. It reserved entry of a monetary award pending further consideration. On appeal, the trustees of the Plan, the officers of Local 688 and Occidental argue that the trial court erred in its interpretation of the Plan documents and that several of its factual findings are clearly erroneous. For the reasons outlined below, we affirm in part, reverse in part and remand for further proceedings.

I.

Factual History

In 1968, Harold Gibbons directed Richard Kavner to develop a joint pension program for Local 688 and the St. Louis Labor Health Institute (LHI). LHI is a nonprofit organization providing medical benefits to union members and is supported by a number of Teamsters' locals, including Local 688. It was established under Gibbons' leadership. During the period that the pension program was under development, Gibbons was Secretary-Treasurer and Chief Executive Officer of Local 688. Kavner, Gibbons' assistant, was supervisor of fringe benefits. LHI and Local 688 subsequently adopted an Agreement and Declaration of Trust which established the LHI-688 Employees Retirement and Pension Plan, effective January 1, 1968.[2] Under the provisions of the agreement, the trustees agreed to administer, under a single trust, contributions made on behalf of LHI

---

[1] The officers of Local 688 were sued as class representatives of the Union membership. Local 688 is affiliated with the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America.

[2] The necessary approval was obtained from the Executive Board of Local 688 and the Board of Directors of LHI.

and Local 688 employees. The agreement, however, contemplated that there would be two separate pension plans—Plan A for LHI employees and Plan B for Local 688 employees.[3] In separate determination letters, the Internal Revenue Service (IRS) held that each plan was a qualified plan under 26 U.S.C. § 401(a), and that the trust was exempt from the federal income tax under 26 U.S.C. § 501(a). From the adoption of the trust and plans in 1968 until March, 1971, the trustees administered the plans on a self-insured basis.

In late 1969 or early 1970, Kavner, at Gibbons' request, entered into negotiations with Occidental to provide increased benefits for employees of Local 688, and to have Occidental "guarantee" the pension benefits of persons then employed by Local 688. After extensive negotiations, Occidental proposed a group annuity contract which provided that employees of Local 688 who met Plan B's eligibility requirements would be entitled to a monthly pension equal to $40 multiplied by the number of years of their credited service, as defined by the plan, up to a maximum of thirty years. Under the original Plan B, an employee received benefits equal to $300 per month for a period of sixty months after retirement and $110 per month thereafter. Occidental also agreed to "guarantee" the benefits of Local 688 employees employed at the time the contract was executed. These individuals were listed on Exhibit B to the contract along with their service date and birth date. The guarantee, § 3.7 of the contract, provides:

> If the conditions of the Contract are met, or if Discontinuance of the Contract occurs after the conditions of the Contract have been met for the first twenty-five Contract Years, Occidental agrees to provid and guar-

---

[3] Plan A and Plan B were originally separate documents that were incorporated by reference into the Agreement and Declaration of Trust.

antee all benefits which shall become payable under the Plan with respect to those Participants who are listed in the Schedule of Participants attached to the Contract as Exhibit B. For the purposes of this Section 3.7, and notwithstanding anything contained in the Contract to the contrary, the Contractholder and Occidental agree that the information and data contained in Exhibit B, as such Exhibit appears at the Contract Date, shall be binding and conclusive. Except as specified in this Section 3.7, Occidental shall not be responsible for the sufficiency of the Deposit Fund to provide the benefits specified in the Plan. Occidental shall have no liability except as provided in the Contract.

The Contractholder and Occidental agree to modify or amend the plan or the Contract appropriately, if such action becomes necessary because of any Federal or State law or regulation which becomes effective after the Contract Date, and which imposes any condition, restriction, limitation or requirement on the operation of either the Plan or the Contract or both which, as determined by Mutual Agreement, would be such as to prevent Occidental from continuing its agreement under this Section.

Occidental agreed to provide these benefits if Local 688 contributed $40 per week per active participant to the pension plan.[4]

In keeping with the unified administration of the LHI-688 Pension Plan, the group annuity contract also provided for benefits to LHI employees. Full-time LHI employees meeting Plan A's eligibility requirements were entitled to

---

[4] The contribution rate was lower during the earlier years of the contract but gradually increased. In 1970, Local 688 was required to contribute $22 per week per active participant; in 1971, $28 per week; in 1972, $34 per week; and in 1973 and thereafter, $40 per week.

$300 per month for a period of sixty months after retirement and $110 per month thereafter. Part-time LHI employees were entitled to $135 per month for a period of sixty months after retirement and $90 per month thereafter. This was the identical level of benefits provided for in the original Plan A. Occidental did not guarantee these benefits. LHI was required to pay $12 per week for each full-time employee and $6 per week for each part-time employee to Occidental.

The trustees of the LHI-688 Pension Plan executed the group annuity contract on March 18, 1971. On the same day, they adopted amended Plans A and B retroactive to January 1, 1968.[5] Under the amended plans, the funds previously accumulated in the trust were transferred to Occidental. The amended plans were submitted to and approved by the IRS. Both LHI and Local 688 have continued to make the contributions required by the contract to Occidental.

Kavner retired on January 1, 1972, and in accordance with the service date specified in Exhibit B, received a pension of $1,200 per month. Saffo retired on August 3, 1973, and received a pension of $800 per month. Gibbons retired in August, 1973, shortly after he had been replaced as Secretary-Treasurer of Local 688 by Ronald Gamache, at a pension of $1,200 per month.[6]

In the summer of 1973, the trustees decided to adopt amendments to Plan B to correct what they considered as shortcomings in the plan. They sought to increase the break-in-service period, provide for vesting and early retirement and reduce the number of years necessary for normal retirement. To pay for these changes, the trustees

[5] The two plans, although retaining distinct provisions, were incorporated into a single document.

[6] Gibbons was forced to resign from his position as Secretary-Treasurer as a result of serious internal strife among the officers and staff of Local 688.

initially considered increasing the $40 per week contribution of Local 688 for its employees. They rejected this option because they believed that Local 688 could not afford it. They then decided to reduce monthly pension benefits from $40 per month to $20 per month for each year of credited service.[7] This reduction in monthly benefits was prospective in nature and affected only those individuals who retired after December 31, 1973. Consequently, the monthly benefits of Saffo, Kavner and Gibbons would not have been altered. The trustees incorporated all of these proposed changes into Amendment 2, which they adopted on November 29, 1973. The adoption was made conditional upon IRS approval.

On July 12, 1974, the IRS District Director for St. Louis notified the trustees that Plan B, if modified by Amendment 2, would no longer qualify as a tax-exempt plan. The letter to the trustees provided in relevant part:

> [I]t is our opinion that these changes to your plan constitute a curtailment or "partial termination" within the meaning of I. T. Reg. § 1.401-6(b)(2).
>
> The effect [that] a curtailment or partial termination will have on the qualified status of a plan depends primarily on (1) the existence of a valid business reason for the termination or curtailment consistent with the assumption that the plan from its inception has been a bona fide permanent program for the exclusive benefit of employees in general, and (2) compliance with the requirements of Section 401(a) of the Code in other respects from its adoption through curtailment. * * *
>
> In the instant case, the plan was amended in 1970 [sic] to provide for the $40 per month benefit for each year of service, and that in less than 4 years, the bene-

[7] These figures were based upon information supplied by Occidental's actuaries.

fits were reduced (as were the Normal Cost figures thereunder) without evidence of business necessity. Absent this business necessity, the original assumption that the plan was a bona fide permanent program must be replaced with the presumption that the Union did not intend the plan to be permanent from the time the $40 benefit was first added in 1970 [sic].

It is further noted that 3 of the 4 former employees who retired during this period were Union officers,[8] members of the class in whose favor discrimination is prohibited by Section 401(a)(4) of the Code, and that between January 1, 1970 and January 1, 1974 (prior to the amendment) the unfounded liability had actually increased, indicating that the contributions made during that period were not sufficient enough to meet current years costs, i.e., normal cost plus interest on the unfunded liability. The presumption of permanency is even more difficult to accept in view of these facts.

Accordingly, it is our opinion that the recent amendment to Plan "B" is to be treated as a partial termination, that neither requirement [(1) or (2) above] was met, and that said amendment has adversely affected the prior qualification of the plan.

The trustees appealed this decision to the Commissioner of Internal Revenue, who affirmed the District Director on March 28, 1975.

On April 25, 1975, the trustees revised the service dates of Kavner and Gibbons as they appeared on Exhibit B. The trustees determined that Gibbons and Kavner had impermissibly attempted to claim service dates based upon years of employment with unions that later merged into Local 688 in addition to their years of employment with

[8] The President of Local 688, John Naber, had also retired during this period. He is not, however, a party to this action.

Local 688. The trustees also determined that Kavner had incurred a break in service, as defined in the LHI-688 Pension Plan, and, consequently, was not eligible to receive any pension benefits. These actions had the effect or [sic] retroactively reducing Gibbons' monthly benefit from $1,200 to $960 and of terminating Kavner's $1,200 monthly benefit.

After the IRS rejected Amendment 2, the trustees proposed Amendment 4. Amendment 4 reduced the monthly benefit level for each year of credited service from $40 to $20.55, and reduced the maximum years of service that could be used in computing the monthly benefit from thirty to twenty-five years. The amendment was retroactive in nature and reduced the monthly benefit payments of all previous retirees as of their respective dates of retirement. Gibbons' monthly pension was reduced from $960.00 to $493.20, and Saffo's monthly pension was reduced from $800.00 to $411.00. The trustees submitted the proposed amendment to the IRS for approval.

On August 11, 1975, the IRS approved the amendment. In a letter to the trustees, it stated:

> You were previously advised that an unexecuted amendment submitted in 1974 would cause the above-named plan to fail of qualification under Section 401 of the Internal Revenue Code. The amendment proposed to reduce the normal retirement benefit for future service from $40 to $20 times years of service. Our objection to the reduction was made under Section 401(a)(4) of the Code because only four employees had retired during the period in which the $40 benefit was in effect, and three of these employees were officers of the Union.
>
> On July 11, 1975, a proposed amendment was submitted to reduce the benefit from $40 to $20.55 for each year of credited service, retroactively effective to November 1, 1970. This amendment, if adopted, will re-

duce the existing benefits now being paid to the four retirees. It will also necessitate the return of the excess amounts already paid since 1970, either as a direct repayment or as an actuarial adjustment against their respective future benefits. The amendment will thus remove the discriminatory treatment apparent in the first proposed amendment.

Accordingly, it is our opinion based on the data submitted that your recently submitted amendment to reduce the benefit retroactively to $20.55 will not adversely affect the qualified status of the plan.

The trustees formally adopted Amendment 4 on September 9, 1975.

At a meeting held on the morning of September 24, 1975, representatives of Occidental informed the trustees that overpayments to the retirees for the period since their respective dates of retirement to September 1, 1975, were as follows:

Harold J. Gibbons [9]	$17,416.80
Richard Kavner [10]	$49,200.00
John Naber	$16,880.00
Charles Saffo	$14,393.00
John Nedich [11]	$ 2,426.40

Occidental further advised the trustees that if each of the retirees' benefits, other than Kavner's, were reduced actuarially to provide for recoupment of the overpayments

---

[9] The amount of overpayment to Gibbons includes excess payments based upon his incorrect service date.

[10] Since the trustees determined that Kavner had not been entitled to receive any pension, the amount of overpayment represents all sums paid to Kavner.

[11] John Nedich is not a party to this action. He retired subsequent to the conditional adoption of Amendment 2.

over a period of years, the reduction in benefits for each retiree would be calculated as follows:

	Reduced from (Monthly)	Reduced to by reason of Amendment No. 4 (Monthly)	Reduced to for actuarial repayment of over-payments (Monthly)
Harold J. Gibbons	$960.00	$493.20	$357.11
John Naber	$880.00	$452.10	$330.00
Charles Saffo	$800.00	$411.00	$284.56
John Nedich	$680.00	$410.00	$376.76

The trustees required Kavner to reimburse them in a lump sum.

The trustees held a special meeting on the afternoon of September 24, 1975. Gibbons, Naber, Saffo and Nedich attended the meeting. They were advised that it was necessary to reduce their benefits pursuant to Amendment 4, and that they would be required to reimburse the trustee either in a lump sum or by a further reduction in benefits. Gibbons and Saffo decided to reimburse the trustees by an actuarial reduction in benefits. It is unclear which option Naber and Nedich chose.

Gibbons, Saffo and Kavner instituted the present action in February, 1976, to have their pension benefits restored. The trial court found for them on the substantive issues. It held that the officers, trustees and Occidental had committed breaches of contract by reducing the payments to Gibbons and Saffo and by terminating the payments to Kavner. The trial court further held that Occidental was liable for actuarial malpractice and breach of contract for failing to inform the IRS of its guarantee and the effect of this guarantee on Plan B. It finally held that Occidental was liable for fraud, malpractice, breach of fiduciary duty and breach of contract for failing to inform the trustees

that Amendment 4 would reduce its liability on the guarantee.

II.

Occidental's Arguments

Occidental raises several issues on appeal. Its arguments can be better understood if we first examine the analysis followed by the trial court in finding Occidental liable. It determined that under the contract Occidental had guaranteed the retirees' monthly benefits for life at the $40 benefit level existent at the date of their retirement. It found that absent the guarantee, Plan B was actuarially unsound under the actuarial assumptions used by Occidental. Consequently, Occidental had assumed the risk of paying out more in benefits than it received in contributions since it could not require increased contributions to pay Exhibit B participants. It held that, under the circumstances, Occidental was a risk taker and not a mere stakeholder.

The trial court also found that as of January 1, 1974, Occidental had incurred an actuarial liability on its guarantee of $1,067,000, and that it had failed to reduce Plan B's unfunded actuarial liability by this amount in its actuarial reports to the trustees and in a valuation summary submitted to the IRS.[12] It concluded that the actuarial reports and valuation summary were misleading, deceptive and inaccurate, that they had caused the District Director of the IRS to question the actuarial soundness of Plan B in his July 12, 1974, letter to the trustees, and that they were a factor in the trustee's decision to adopt Amendment 4.

The trial court further found that Occidental knowingly failed to disclose to the trustees, in its reports to them, that Amendment 4 had the effect of reducing its actuarial liability on the guarantee by over $800,000. It concluded

---

[12] The valuation summary was requested by the IRS after the trustees had submitted Amendment 2 to the IRS for approval.

that the reports were false and materially misleading, and that the trustees relied upon them in their decision to adopt Amendment 4.

The trial court held that Occidental was liable for actuarial malpractice and breach of its contract to provide actuarial services and reports. This holding was based on its failure to inform the IRS that it had guaranteed over $1,000,000 of what it showed as the unfunded actuarial liability of Plan B. It also held Occidental liable for fraud, malpractice, breach of fiduciary duty and breach of its contract to provide services and reports for failing to inform the trustees that Amendment 4 would reduce its own liability by over $800,000. It finally held that Occidental had committed breaches of contract in reducing its payments to Gibbons and Saffo and stopping its payments to Kavner.[13]

A.

The Guarantee

We initially consider Occidental's arguments that the trial court erred in its interpretation of the guarantee and the guarantee's relationship to the LHI-688 Pension Plan. Occidental first argues that the guarantee is not a promise by it to pay the retirees' monthly benefits for life at the $40 benefit level existing at the date of their retirements. It contends that the guarantee only provides for payment of benefits "which shall become payable under the Plan," not fixed dollar amounts.

We find little merit to this argument. At the time the group annuity contract was executed, Plan B, as amended, provided that:

> The amount of Normal Retirement Annuity for a Participant in the employ of Teamsters Local 688 will

---

[13] Occidental was found liable to the retirees based upon third-party-beneficiary principles.

> be equal to $40, multiplied by the number of years of Credited Service completed by the Participant at his Normal Retirement Date, up to a maximum of thirty years. Monthly payments of such Normal Retirement Annuity will commence on the Participant's Normal Retirement Date and will be payable thereafter for as long as he lives.

Occidental was fully aware of this $40 benefit level, and it had based its guarantee and its contribution rate on that level. For example, a May 15, 1970, letter from a vice-president of Occidental stated that:

> Our actuaries have stated that a benefit of $40.00 per month for each year of service up to a maximum of 30 years can be provided by the following contributions:
>
> Effective January 1, 1970—$22.00 per week
> Effective January 1, 1971—$28.00 per week
> Effective January 1, 1972—$34.00 per week
> Effective January 1, 1973—$40.00 per week

In a September 8, 1970, letter acknowledging receipt of the names, birth dates and service dates of the Exhibit B participants, the same vice-president stated that this "will be the date upon which the proposed guarantee will be based." . . .

Occidental next argues that the guarantee is not effective until the group annuity contract has been in force for twenty-five years. Neither the language of the guarantee nor the intent of the parties supports this argument. The language of the guarantee indicates that it was effective immediately and is to remain in effect as long as the other conditions of the contract are being met. The only mention of a twenty-five-year condition is in the first paragraph of the guarantee which states that even if the contract is discontinued after twenty-five years, Occidental will con-

tinue to pay benefits to Plan B participants. Moreover, the evidence shows that the officers of Local 688 were concerned with providing pension benefits to Exhibit B participants that would be guaranteed during their lifetimes Occidental recognized this concern and attempted to provide for it in the guarantee. Since several individuals retired shortly after the guarantee was written, it is incredible to suggest that the negotiators for Local 688 would have been satisfied with a guarantee that would not take effect for twenty-five years.

Occidental also argues that the guarantee does not become effective until the Deposit Fund becomes exhausted. This fund contains the accumualted [sic] contributions of both Local 688 and LHI. The contract does not support this requirement.

Section 2.3 of the contract provides:

> Occidental will notify the Contractholder if the Deposit Fund is not sufficient to permit any withdrawal required by Section 3 with respect to any Participant who is not listed in the Schedule of Participants attached to the Contract as Exhibit B. The Contractholder will be required to make a Deposit sufficient to permit the withdrawal. The Deposit will be due on the date stated in the notice.

Under the interpretation urged by Occidental, the guarantee would effectively become a dead letter since the Deposit Fund cannot be exhausted. Occidental could merely use the fund to pay Exhibit B participants and then demand additional contributions for other participants in accordance with § 2.3. In order to prevent this, the contract provides in § 7.24:

> Occidental shall furnish the Contractholder with the following reports * * *.

On a Contract Year basis:

* * * *

Actuarial Report—A report on the actuarial sufficiency of the funds maintained under the Contract. The report will indicate the level the Plan benefits which can be supported by the contributions which are being made in connection with the Plan. However, *nothing contained in the actuarial report can in any way alter the agreement evidenced in Section 3.7* [the guarantee]. (Emphasis added.)

In other words, if the contributions for Exhibit B participants are too small to pay Exhibit B retirees, it would be a violation of § 7.24 for Occidental to use money contributed for non-Exhibit B employees to make up that deficit and then demand higher contributions for the non-Exhibit B people to make up for a resultant shortage in that account.

Occidental next argues that it could not pay the retirees' monthly benefits based on the $40 benefit level without having several "conditions" embodied in the contract broken. The first of these is the condition that the plan be maintained as a qualified plan. Section 7.22 of the contract provides that:

> [t]he [trustees agree] to keep and maintain the Plan as a qualified tax-exempt plan under the applicable code sections of the Internal Revenue Code and regulations and rulings of the Internal Revenue Service.

Occidental reasons that the IRS required the trustees to adopt Amendment 4 in order to remove plan discrimination in favor of union officials. Thus, it had no alternative but to reduce the benefit level from $40 to $20.55 so as to preserve the plan's tax-exempt status.

We do not agree that the IRS required the trustees to adopt Amendment 4. The July 12, 1974, letter from the IRS

simply notes that Amendment 2, as adopted, was discriminatory under 26 U.S.C. § 401(a)(4) because the three retirees, who were union officers, would be receiving higher monthly benefits than subsequent retirees. The IRS was concerned with the differential benefit structure and not the level of benefits per se. Nothing in the letter suggests that the trustees must reduce the monthly benefits in order to remove the discrimination and preserve the plan's tax-exemption. From what appears in this record, the IRS would not have objected if the trustees had rescinded their conditional adoption of Amendment 2 and returned to the original plan. Occidental obviously had an interest in not suggesting this as an alternative because Amendment 4 reduced its liability under the guarantee.

The second of these is the condition that both LHI and Local 688 contributions were to be used as a common fund to support all pension benefits under either Plans A or B. Occidental asserts that in 1975, the trustees directed it to separate Plans A and B because the IRS had objected to the "pooling" of contributions in order to support Local 688 pensions. It contends that this action deprived it of the single fund and, in effect, abrogated § 2.1 of the contract which provides that:

> [I]n no event shall the amount payable to Occidental under the Contract be any less than the sum of the contributions which are payable with respect to all Participants under the Plan [which includes employees of both LHI and Local 688].

We agree with the trial court that the evidence does not support this contention.

At trial, Occidental attempted to prove that pooling was necessary in order to sustain the benefit levels requested by Local 688. Richard Eskoff, a vice-president of Occidental, related his experiences in negotiating the contract. He stated that after the initial meetings with Kavner in late

1969 and early 1970, Occidental proposed a pension program in May, 1970, with benefits almost identical to those provided under the original plan. Given the same benefit level, the various representatives of the LHI-688 Pension Plan saw no advantage in accepting the proposal. It was at that point that pooling was discussed as an alternative.[14] Occidental then reworked the contract so as to produce a higher benefit level. In doing so, it utilized contributions made on behalf of LHI to fund the higher benefits of Local 688.[15] Thus, it argues that pooling was an essential element of the contract.

This account is simply unsupported by the actuarial evidence. In its May, 1970, proposal, Occidental calculated the following contributions for LHI:

	Full-time employees	Part-time employees
Effective January 1, 1970	$12.00 per week	$6.00 per week
Effective January 1, 1971	$13.00 per week	$7.00 per week
Effective January 1, 1972	$14.00 per week	$8.00 per week

These contributions would have supported benefits for full-time employees of $300 per month for the first sixty months after retirement and $110 per month thereafter for life; and for part-time employees of $120 per month for the first sixty months and $44 per month thereafter.

In the final contract, the contributions were *less* than in the proposal:

Full-time employees	$12.00 per week
Part-time employees	$ 6.00 per week

[14] Eskoff could not recall who suggested the idea first.

[15] Occidental also notes that in IRS Form 4573, the Application for Determination of tax-exempt status, the trustees indicated that Local 688 would not be supplying all of the contributions necessary to provide benefits.

The benefits for full-time LHI employees, however, were the same as in the proposal, and the benefits for part-time employees actually *increased* to $135 per month for sixty months and $90 per month thereafter. Considering this evidence, we fail to see how Occidental can claim that there were excess LHI contributions to, in effect, subsidize Local 688 benefits when the LHI contributions were less and the benefits greater under the "pooled" contract than under the segregated one.

The third of these conditions is the requirement in § 3.1 of the contract which provides that:

> Occidental shall make withdrawals from the Deposit Fund to provide benefits under the Contract only as directed by the Contractholder.

Occidental claims that the trustees directed it to pay benefits based on the $20.55 level and that it would violate the contract if it did otherwise. This contention is merely a variation of Occidental's argument that it was not required to pay each of the retirees' monthly benefits at the $40 level because it had only promised to pay benefits "which shall become payable under the Plan." For the reasons previously discussed, we find little merit in this contention.

Occidental's final argument in regard to the guarantee is that the trial court's finding that Occidental's guarantee had a value of $1,067,000 for actuarial purposes was clearly erroneous. *See United States v. United States Gypsum Co.*, 333 U.S. 364, 395 (1948); *Nye v. Blyth Eastman Dillon & Co., Inc.*, 588 F.2d 1189, 1196 (8th Cir. 1978); *Shull v. Dain, Kalman & Quail, Inc.*, 561 F.2d 152, 155 (8th Cir. 1977), *cert. denied*, 434 U.S. 1086 (1978). We conclude that it is not.

Louis G. Prange, an actuary, prepared an estimated present value of the shortfall in Local 688 contributions compared to the value of benefits to be paid to Exhibit B par-

ticipants. The present value of the shortfall indicates the cost to Occidental of its guarantee to Exhibit B participants. His calculations were based on assumptions and cost methods similar to those of Occidental and were as follows:

Year	Present Value of Benefits	Allocated Share of Assets	Present Value of Future Employer Contributions for Schedule B Participants	Present Value of Shortfall (1)-(2)-(3)
1970	$1,215,000	$ 33,000	$365,000	$ 818,000
1971	$1,698,000	$ 71,000	$617,000	$1,010,000
1972	$1,745,000	$134,000	$586,000	$1,026,000
1973	$1,734,000	$187,000	$516,000	$1,043,000
1974	$1,695,000	$221,000	$406,000	$1,067,000

Thus, at the time the contract was issued, Occidental apparently anticipated a loss of approximately $800,000, which amount increased to $1,067,000 in 1974.

Occidental asks us "to take judicial notice that insurance companies do not give away $1,000,000." We need not make a lengthy inquiry into Occidental's motives for its actions. We do note, however, that some evidence was presented at trial indicating that Occidental anticipated a higher rate of employee turnover than provided for in its actuarial calculations which would have reduced its potential liability. Moreover, Occidental may have desired to accommodate Gibbons because it handled several other pension plans involving Local 688 and the International.[16] As a vice-presi-

[16] Occidental also handled the Teamsters Negotiated Pension Plan, a multi-employer pension plan, and the Teamsters Insurance and Welfare Fund. *See Celeste M. Castello v. Ron Gamache, et al.*, No. 78-1755, slip op. at 1-2 (8th Cir., March 9, 1979).

dent in the International and as the Secretary-Treasurer of Local 688, Gibbons could have adversely affected Occidental's arrangements with these plans if he became displeased with Occidental.[17]

B.

Remaining Arguments

Occidental argues that the trial court was clearly erroneous in finding that Plan B was actuarially unsound under the actuarial assumptions used by Occidental excluding the guarantee. Occidental concedes that Plan B was actuarially unsound absent the pooling of Plans A and B.[18] We have previously concluded that pooling was not an integral part of the contract. Consequently, it is unnecessary for us to address this argument further.

Occidental raises several arguments concerning the trial court's findings of breach of contract, malpractice, fraud and breach of fiduciary duty. It contends that these findings are clearly erroneous, reiterating many of the arguments

[17] Occidental also argues that it would be improper, under 26 U.S.C. § 412(c)(2), for it to include the $1,067,000 as a pension plan asset. Insofar as the trial court did not require it to do so, we need not decide the issue. Louis Prange suggested several alternative methods of disclosing the value of the guarantee.

[18] Louis Prange demonstrated that expected contributions of Local 688 were significantly less than the minimum funding necessary to sustain the benefit level. His calculations were as follows:

	Plan B	
Plan Year	Minimum	Expected
1970	$115,784	$30,888
1971	$138,413	$72,800
1972	$119,734	$83,096
1973	$113,091	$81,120
1974	$131,523	$87,360

it made with respect to the guarantee. We have carefully examined these arguments and find them to be without merit.

Occidental finally argues that if it is held liable in damages for complying with IRS-required changes to the LHI-688 Pension Plan, it was deprived of due process. As we have previously concluded that the IRS did not require these changes, we find this argument to be without merit.

III.

The Remaining Appellants' Arguments

The trustees of the LHI-688 Pension Plan and the officers of Local 688 raise several additional issues on appeal. They argue, initially, that the trial court erred in determining that the trustees acted in violation of the plan and the trust agreement when, in accordance with Amendment 4, they directed Occidental to change payments to the retirees.[19] The trustees and officers contend that the retirees' pension rights are merely contractual and are governed by the terms of the plan documents. Since Plan B allowed the trustees to amend it, the retirees' rights could be adversely affected at a later date, provided that the trustees acted reasonably and in a manner consistent with the purposes of the trust agreement and the plan. When the IRS disqualified the plan and found it to be severely underfunded, the trustees were confronted with a situation that endangered the plan's survival. Under the circumstances, they argue it was appropriate and reasonable for them to adopt Amendment 4, and that their judgment should not be overturned by the trial court.

We disagree with the analysis of the trustees and officers. The retirees' pension rights are not as amorphous as

---

[19] They do not contest the trial court's findings that the trustees were under the domination and control of Local 688 and that Local 688 permitted the trustees to change retirees' payments.

they suggest. Ordinarily, pension rights, once they have vested, may not be altered without the pensioner's consent.[20] *Allied Chemical & Alkali Workers v. P. P. G. Co.,* 404 U.S. 157, 181 n.20 (1971); *see* Note, *Pension Plans and the Rights of the Retired Worker,* 70 COLUM. L. REV. 909, 916-920 (1970). The retirees' pension rights were vested as they had complied with all conditions entitling them to participate in the plan [21] and had begun to receive benefits under it. *See Molumby v. Shapleigh Hardware Company,* 395 S.W.2d 221, 227 (Mo. Ct. App. 1965); *Feinberg v. Pfeiffer Company,* 322 S.W.2d 163 (Mo. Ct. App. 1959).[22] Moreover, the trustees' ability to divest a retiree of his pension benefits was strictly limited by § 10.5 of the pension plan which provides that:

> [i]n no event may any amendment be made to the Plan which:
>
> * * * *

---

[20] Section 203(a) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1053(a), sharply limits the situations in which vested rights can be divested. *Henry Winer v. Edison Brothers Stores Pension Plan,* No. 78-1327, slip op. at 7-8 (8th Cir., Feb. 21, 1979). ERISA § 203(a) is not applicable to this case, however, since the decision to reduce or terminate retirees' benefits occurred prior to January 1, 1976. *See Henry Winer v. Edison Brothers Stores Pension Plan, supra* at slip op. 9-12.

[21] We conclude later in the opinion, however, that Kavner did not meet the plan's eligibility requirement and that he and Gibbons committed fraud with respect to their service dates.

[22] ERISA § 514(a), 29 U.S.C. § 1144(a), preempted all state law as it might relate to any employee benefit plan, with a few exceptions, effective January 1, 1975, although ERISA § 203(a) did not become effective until after December 31, 1975. Note 19, *supra.* During this "gap" period, however, we may properly look to pre-ERISA state law. *See Keller v. Graphic Systems of Akron, Inc.,* 422 F.Supp. 1005, 1007-1009 (N.D. Ohio 1976). *But see Amory v. Boyden Associates,* 434 F.Supp. 671 (S.D. N.Y. 1976).

> (b) will divest any Participant of any benefit credited to him under the Plan before the effective date of the amendment, except as the same may be required by the U.S. Internal Revenue Service as a condition of preserving the Trust's Federal tax exempt status.

We also disagree with the trustees and officers that the IRS ever disqualified the plan. The August 11, 1975, letter from the IRS speaks of the "unexecuted amendment" that "would cause the above-named plan to fail of qualification." Our fundamental problem with their analysis, however, is the implication that there is a causal connection between the plan's underfunding and a disqualification. The IRS did not suggest that the plan would be disqualified unless the trustees corrected the underfunding. In fact, the trial court found that the trustees were unreasonable in concluding that the IRS required them to reduce retirees' benefits in an amount sufficient to make the plan actuarially sound in order to maintain the plan's qualification. This finding is not clearly erroneous.

The IRS commented on the actuarial soundness of the plan during its analysis of whether the increase in Local 688 benefits, occurring in 1971, was intended to be a permanent part of the plan or whether it was intended to be a temporary increase designed primarily to benefit former union officers. It observed that the plan's unfunded liability had increased between January 1, 1970, and January 1, 1974. It implied that, since this situation could not go on indefinitely, Amendment 2 was simply another step in an overall plan to reward the former union officers by increasing benefit levels during the period of their retirement.[23] The IRS concluded that if Amendment 2 were adopted, the plan would be disqualified. It did not, how-

---

[23] The IRS did not have before it the evidence showing that the plan was not actuarially unsound since Occidental had guaranteed the benefits of Exhibit B participants. *See* Part II.A., *supra*.

ever, condition the plan's continued qualification on the removal of any underfunding.

We also observe that the trustees could not have adopted those portions of Amendment 4 which divested the retirees of their pension rights without violating § 10.5 of the plan unless the IRS required them to do so in order to preserve the plan's tax-exempt status. We conclude that the IRS did not. As we have previously observed in Part II.A., there is no language in either letter from the IRS to suggest that the plan would be disqualified unless the trustees reduced the retirees' pension benefits. The August 11, 1975, letter merely notes that Amendment 4 eliminated the objectionable features of Amendment 2. The trustees could have rescinded their conditional adoption of Amendment 2 and returned to the original plan.[24]

The trustees and officers finally argue that several other findings of the trial court are clearly erroneous. To understand these arguments, we set out in some detail additional information concerning Gibbons' and Kavner's employment background.

Gibbons was first employed by the American Federation of Teachers in Chicago in the early 1930's. In 1936, he be-

---

[24] There is some suggestion in the trial court's decision that Amendment 4 was not adopted in good faith. The evidence does indicate some self-dealing on behalf of the new officers of Local 688. An unknown portion of the reduction in benefits was attributable to changes in the plan that were unnecessary to correct either the underfunding or the impermissible discrimination. Amendment 4 not only reduced retirees' pensions, it (1) increased the break-in-service provisions from twelve months to forty-eight months; (2) reduced the minimum service necessary to qualify from twenty years to fifteen years; (3) provided for early retirement at age fifty with ten years of service; and (4) provided for early vesting. The only individual who benefited from increasing the break-in-service provision to forty-eight months was Ronald Gamache, the new Secretary-Treasurer of Local 688. Moreover, there is no evidence that Amendment 4 actually eliminated the purported underfunding.

came the Assistant Director of the CIO in Chicago. From 1937 until 1940, he was Subregional Director of the Textile Workers Union in Louisville, Kentucky. He was assigned by the Textile Workers to work in Kansas City, Missouri, in 1940. In 1941, he was hired as the Chief Executive Officer of the St. Louis Joint Board of the International Retail, Wholesale and Department Store Employees Union, CIO. In 1948, he was instrumental in disaffiliating the St. Louis Joint Board from the International Retail, Wholesale and Department Store Employees Union. The St. Louis Joint Board continued as an independent organization until 1949, when it merged with Local 688. Prior to the merger in 1949, the St. Louis Joint Board had no affiliation with the Teamsters. Local 688 preexisted the merger and was separate and distinct from the St. Louis Joint Board. Thus, Gibbons' first employment by Local 688 was in 1949.

Kavner was employed by the International Retail, Wholesale and Department Store Employees Union, CIO, from 1939 until 1942, when he entered the armed services. In 1946, Kavner returned and was reemployed by the same organization. In the latter part of 1946, Kavner was assigned by the International to St. Louis. He remained in St. Louis until the merger in 1949, at which time he, too, was first employed by Local 688.

From February, 1954, until January, 1955, Kavner worked on a special organizing program with the Missouri-Kansas Conference of Teamsters and from February, 1955, until February, 1958, he worked as a "trouble shooter" for the Central States Conference. Kavner received a written leave of absence from Local 688 for both assignments. From March, 1958, through December, 1963, Kavner was employed by the Teamsters as a General Organizer. During this period, his salary, expenses and fringe benefits were paid by the International. He did not receive a written leave of absence for this assignment.

On the basis of the merger of the St. Louis Joint Board with Local 688, Gibbons and Kavner claimed service dates from 1938 and 1939, respectively, on Exhibit B. The trustees and officers argue that in doing so, Kavner and Gibbons perpetrated a fraud on the plan. The trial court found that they had not committed any fraud. We conclude that this finding is clearly erroneous.

At the time Gibbons and Kavner retired, there was no plan provision that authorized credit for past service with any employer other than Local 688. Section 1.11(a) of the plan provides:

> *Credited Past Services*—Each Employee who is in the employ of the Employer on the Effective Date will be credited with one year of Credited Past Service for each calendar year prior to the Effective Date in which he had at least 300 hours of continuous employment as an Employee or ten weeks in the armed forces of the United States.

An "Employee" is defined as an employee of Local 688 under Plan B. Gibbons and Kavner were aware of this provision yet they claimed past service credits from 1938 and 1939, respectively, although 1949 was the earliest date Local 688 had employed either of them. Moreover, employees of other merged unions were not given credited service for years of employment prior to their employment directly by Local 688.

The trustees also determined that Kavner suffered a break in service within the meaning of Plan B from March, 1958, through December, 1963, when he was employed as a General Organizer for the International. Consequently, he did not meet the plan's eligibility requirements for benefits. The trial court found that Kavner did not have a break in service. We conclude that this finding is clearly erroneous.

The plan provided that an employee's credited service would be broken if he left the service of Local 688 for a period of at least fifty-two consecutive weeks unless the employee has been granted a leave of absence in writing in a manner consistently and uniformly applied to all other employees or was in the armed forces of the United States. Kavner contends that he was granted an oral leave of absence by Gibbons when he accepted employment as a General Organizer. It is clear, however, that the plan requires a written leave of absence in order to avoid a break in service. Kavner was aware of this requirement and had obtained written leaves of absence when he had accepted other positions outside of Local 688. Moreover, since other employees suffered breaks in service upon receiving transfers to other Teamster organizations, allowing Kavner to utilize an oral leave of absence would violate the plan's requirement of uniform and consistent application.[25]

We conclude that under the circumstances, the trustees acted reasonably in reducing Gibbons' monthly benefit from \$1,200 to \$960 because of his decrease in years of credited service, and in discontinuing Kavner's \$1,200 monthly benefit because of his break in service and seeking to recover the related overpayments.[26]

---

[25] Kavner will continue to receive deferred compensation from Local 688 of \$720 per month, \$300 per month from the Central States Pension Fund, \$1,046 per month from the Affiliates Pension Plan, \$108 per month from the Banquet Foods Pension Plan, \$1,300 per month from Labor Management Service Corporation, \$300 per month from Local 102 and \$300 per month from Council Plaza Redevelopment Corporation.

[26] Due to our disposition of the case, it is unnecessary for us to determine whether Kavner's retirement was merely a sham.

IV.

Conclusion

The trial court's decision with respect to Saffo is affirmed. Its decision with respect to Gibbons is affirmed insofar as it relates to the decrease in the monthly benefit level, and reversed insofar as it relates to the reduction in benefits due to the incorrect service date. Its decision with respect to Kavner is reversed.

With respect to the damage issues, the trial court indicated that it was inclined to order payments of back benefits due, declare the rights of the parties under the pension plan and order continued payment of the monthly benefits. In that event, Saffo would be entitled to receive a monthly payment of $800 and Gibbons would be entitled to receive a monthly payment of $960. Occidental would make these payments out of the assets of Plan B and, in accordance with its guarantee, would be liable for any deficiencies. Saffo and Gibbons would also be entitled to receive back payments. The trial court also permitted the parties to agree upon a proper amount of damages, including a lump sum representing the present value of the retirees' benefits. The parties obviously retain this option.

The decision of the trial court is affirmed in part, reversed in part and remanded for further proceedings consistent with this opinion.

Each party shall bear its own costs.

Benson, Chief District Judge, concurring in part and dissenting in part.

I concur in the holding that the trustees acted reasonably in reducing Gibbons' monthly pension from $1,200 to $960 because of the decrease in his years of credited service, and in discontinuing Kavner's pension because of a break in service. Further, I would concur in a holding that the trustees had no authority to reduce Gibbons' and Saffo's

monthly pensions to implement Amendment 4 unless such reduction was required to maintain the plan as a qualified plan, but will offer a further comment on the effect of such a holding. With respect to the holding of liability on the part of Occidental, I respectfully dissent.

When the trustees approached Occidental to negotiate the payment of benefits under a group annuity contract, they were interested in obtaining a benefit level that was more advantageous than under the original plan. Occidental's first set of figures provided for a level of benefits that was almost identical to the original plan. This proposal was not acceptable to the trustees, so the pooling of the LHI-688 Plan funds was discussed. It is immaterial who initiated the discussion. It is clear that only the employees of Local 688 stood to gain from pooled funding, and that it was the trustees who pursued the idea. Occidental's actuaries prepared a second proposed schedule of contributions and level of benefits based upon a pooled method of funding. Under this proposal, Local 688 retirees would receive a monthly pension of $40 per year of credited service, a figure which was considerably higher than the benefit level under the original plan.[1] The trustees accepted this proposal and incorporated the $40 benefit level into Plan B. The proposed schedule of employer contributions, which was also based upon pooled funding, was attached to the group annuity contract as Exhibit C and made a part thereof.

Both Occidental and the trustees expressed serious doubt as to whether the IRS would approve the LHI-688 Plan on a pooled funding basis. The trustees were responsible for filing an application with the IRS for a determination of tax-exempt status. Prior to the submission of the

---

[1] Occidental informed the trustees that Plan B would not be actuarially sound if it were isolated from Plan A, and that a considerably higher contribution rate would be necessary if Local 688 contributions were to fully support the $40 benefit level for Local 688 employees.

plan to the IRS, Occidental wrote to the trustees to confirm that the legal and binding effect of the group annuity contract was contingent upon IRS approval of the LHI-688 Plan. The trustees fully intended to submit the LHI-688 Plan to the IRS as a single plan with a common fund, but with different benefit and contribution levels for the two subplans. However, rather than filing a single application, they filed separate applications for determination as to Plans A and B. The applications indicated that not all of the contributions were to be paid by the employer in question, and the schedule of contributions (Exhibit C to the group annuity contract) was submitted as an explanatory reference. The explanation on the applications may not have been clear to the IRS because it issued separate determinations approving tax-exempt status for Plans A and B without comment on the fact that a pooled method of funding was being utilized. The trustees informed Occidental that the LHI-688 Plan had been approved, and both Occidental and the trustees thereafter proceeded on the assumption that the IRS had approved the pooled funding. Whether or not pooled funding was appropriate for the LHI-688 Plan, the evidence clearly and overwhelmingly shows that the trustees and Occidental both considered pooled funding to be a basis of their bargain, and that it was an integral part of the group annuity contract.

Under § 3.7 of the group annuity contract, Occidental guaranteed (1) during the first 25 years of the contract, to pay the pensions of the Exhibit B retirees to the extent the schedule of contributions was insufficient to support the level of benefits under the plan, provided all employer contributions were made as scheduled; and (2) if the contract were discontinued after 25 years, and all conditions had been met during that time, to pay the entire pensions of the Exhibit B participants.

If, at any time during the first 25 years of the contract, the amount in the deposit fund were insufficient to pay the

full benefits owed to all retirees, the amount in the fund would be prorated among the retirees in proportion to the amounts of their monthly pensions. Occidental would then be required, under its guarantee, to pay the balance of the benefits owed to Exhibit B retirees, and the employer would be required to make a deposit sufficient to pay the balance of the benefits owed to non-Exhibit B retirees.

The trial court adopted as its finding the opinion of plaintiffs' expert, Louis G. Prange, that Occidental's guarantee had an actuarial value of approximately $800,000 at the time the contract was executed, which value increased to over $1,000,000 by 1974. This "value" represented the amount by which the present value of Local 688 contributions for Exhibit B participants was exceeded by the present value of benefits to be paid to Exhibit B participants, without taking into account any pooling of the funds of Plans A and B.

It is undisputed that Plan B standing alone was never actuarially sound. The Local 688 contribution schedule prepared by Occidental was never intended to fully support the benefit level for Local 688 employees. Pursuant to the parties' agreement, Occidental's actuaries prepared the schedule of contributions and benefit levels on a pooled funding basis.

Under the evidence, Occidental had no reason to suspect that the IRS had not approved the LHI-688 Plan as a pooled fund. The first indication to Occidental that the IRS had not granted such approval came in 1974 when the IRS requested segregated financial data for Plan B in connection with its consideration of Amendment 2. Under these circumstances, Occidental did not act inappropriately in calculating the contribution schedules and benefit levels on a pooled funding basis.

Occidental did not have an anticipated loss of approximately $800,000 at the time it entered into the contract. The

intent of the parties was that the guarantee constituted an undertaking on the part of Occidental to pay benefits to the Exhibit B retirees to the extent the pooled fund could not support the payment of such benefits. It is undisputed that the LHI-688 Plan was never actuarially unsound when considered as a pooled fund. Consequently, there was no basis for the assignment of an actuarial value to Occidental's guarantee. The trial court's findings with respect to the actuarial value of the guarantee are clearly erroneous.

The trial court's findings of breach of contract, malpractice, fraud and breach of fiduciary duty on the part of Occidental are also clearly erroneous. The evidence clearly shows that the problems which arose from the "purported underfunding" of Plan B stemmed from the trustees and not from Occidental. The trustees' applications to the IRS did not indicate clearly that a pooled method of funding was being employed.[2] The IRS apparently did not become

---

[2] The IRS "Application for Determination" form included three categories to describe the plan's employer contribution formula: "All," "Balance necessary," and "Other (Specify)." The trustees checked the "other" category and designated Exhibit C to the group annuity contract as the explanation of the formula.

Exhibit C provided:

SCHEDULE OF PARTICIPANT CONTRIBUTIONS
(as referred to in Section 2.1 of Contract)

Scale of contributions payable under the Plan as of January 1, 1970 with respect to each active participant in the Plan:

As to St. Louis Labor Health Institute—

Full-time employees	$12.00 per week per active participant
Part-time employees	$ 6.00 per week per active participant

As to Teamsters Local 688—

Calendar year 1970	$22.00 per week per active participant
Calendar year 1971	$28.00 per week per active participant
Calendar year 1972	$34.00 per week per active participant
Calendar year 1973	$40.00 per week per active participant

This was the only explanation in the application as to how the LHI-688 Plan was funded.

aware of the pooled funding until Amendment 2 was submitted in 1974. The trustees' adoption of Amendment 4 was motivated in part by the IRS's questioning of the financial soundness of Plan B. The adoption of Amendment 4 in turn resulted in the reduction of Gibbons' and Saffo's pensions.

The trustees' adoption of Amendment 4 was also motivated in part by their desire to increase the number of Local 688 employees who would be eligible for benefits, particularly themselves. I agree that the trustees had no authority to reduce Saffo's and Gibbons' pensions to implement Amendment 4. However, the effect of this part of the court's holding deserves further comment. A review of the history of Plan B will be helpful to this discussion.

Under the original version of Plan B, employees would receive a pension of $300 per month for the first 60 months of their retirement and $110 per month thereafter. In 1971, the plan was amended to increase monthly benefits to $40 per year of credited service. Amendment 2, which would have gone into effect on January 1, 1974 if approved by the IRS, provided for reduction of the monthly benefit level from $40 to $20 per year of credited service for all future retirees. Thus, it would not have applied to the four employees who had retired while the $40 benefit level was in effect, including Gibbons, Kavner and Saffo.

In ruling on Amendment 2, the District Director of the IRS held that the reduction of benefits after only a short time, without evidence of business necessity, created a presumption that the plan was not intended to be permanent from the time the $40 benefit level was added. The District Director also noted the unfunded liability of Plan B had been increasing, and that three of the four employees who had retired at the $40 benefit level were union officers, members of the class in whose favor discrimination is prohibited by 26 U.S.C. § 401(a)(4). Amendment 2 was held to be a partial termination of Plan B, which would adversely affect the plan's qualification.

The trustees appealed this decision to the Commissioner, who affirmed the adverse ruling both as to lack of business necessity and as to the discriminatory effect of the amendment. However, the Commissioner ruled the discrimination question was dispositive, stating:

> As it turns out, the $40 per month rate obtains only during a relatively short period of time and benefits primarily officers of the Employer rather than employees in general.
>
> Thus, it is our conclusion that the partial termination of the Plan resulting from Amendment No. 2 produced discrimination of the type prohibited by section 401(a)(4) of the Code. In this regard, it is immaterial whether or not there was a valid business reason for the partial termination, and whether or not Plan A and Plan B are treated as one plan or as separate plans.

The trustees subsequently adopted Amendment 4, which provided for a reduction of monthly benefits from $40 to $20.55 per year of credited service for all employees, including those who had already retired under the $40 level. When Amendment 4 was submitted for IRS approval, the District Director held that if the "excess" amounts already paid to the retired employees were recouped, Amendment 4 would remove the discriminatory treatment that had been apparent in Amendment 2, and would not adversely affect the plan's qualification. Thereafter, Amendment 4 was put into effect, and the trustees began to recoup the "overpayments."

Under the court's holding, Gibbons and Saffo will be entitled to monthly benefits of $40 per year of credited service, just as they were prior to the adoption of Amendment 4.[3] Employees who retire after the effective date of

---

[3] Other employees who retired prior to the effective date of Amendment 4 will also be entitled to reinstatement of their pen-

Amendment 4 will be entitled to monthly benefits of $20.55 per year of credited service as provided by Amendment 4. The effect of the court's holding is to limit Amendment 4 to prospective application, just as Amendment 2 was intended to do. And, as was the case with Amendment 2, the $40 rate will primarily benefit officers of Local 688. Thus, the court's holding will reinstate the discriminatory effect that was present in Amendment 2.[4]

In order to preserve the plan's qualification as a tax-exempt plan, the trustees will have no choice but to eliminate the discrimination through revocation of Amendment 4 and reinstatement of the $40 benefit level for all Local 688 employees. Because a pooled method of funding is no longer being used, a substantial increase in Local 688's contributions to the plan will be required to support the higher level of benefits. There is substantial evidence in the record which indicates that Local 688 will not be able to afford this increase in contributions and may be forced to abandon the plan.

A true copy.

Attest:

ROBERT C. TUCKER
CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT

---

sions at the $40 rate. This, of course, does not include Kavner. His pension was discontinued because of a break in service, not because of Amendment 4.

[4] Such discrimination is prohibited by 26 U.S.C. § 401(a)(4), and is also contrary to § 10.5 of the LHI-688 Plan, which provides in part:

> In no event may any amendement be made to the Plan which:
>
> * * *
>
> (c) will cause or effect any discrimination in favor of officers or individuals whose principal duties consist of supervising the work of others, or highly compensated employees.

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

Consolidated Cases
No. 76-172 C (2)
No. 76-201 C (2)

CHARLES SAFFO, et al., *Plaintiffs,*

v.

OCCIDENTAL LIFE INSURANCE COMPANY OF CALIFORNIA, et al.,
Defendants.

JUDGMENT

(Filed in U.S. District Court June 29, 1978)

In accordance with the Memorandum of this Court filed this date and incorporated herein,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiffs have judgment against defendants on plaintiffs' complaint in an amount to be determined later; and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants pay the costs of this action.

Dated this 29th day of June, 1978.

/s/ H. KENNETH WANGELIN
United States District Judge

Memorandum

(Filed in U.S. District Court June 29, 1978)

These consolidated actions concern the reduction or elimination of pension payments to three retired employees of the Warehouse and Distributors Workers Union, Local 688 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America. Defendants are Occidental Life Insurance Company of California (Occidental), the Trustees of the Pension Plan established for employees of both Local 688 and the St. Louis Labor Health Institute (LHI) and Local 688. Plaintiffs Gibbons and Kavner are former officers of Local 688 and plaintiff Saffo is a former employee who was not an officer.

The Court has jurisdiction over these actions pursuant to 29 U.S.C. § 1132. A fairly lengthy non-jury trial was had and the Court has reviewed the entire record. Basically the issue before the Court is whether the Trustees acted appropriately in reducing plaintiff's [sic] pension benefits to attempt to qualify as a tax exempt pension plan. After consideration the Court makes the following findings of fact and conclusions of law.

Findings of Fact

1. In 1965 Local 688 established a pension plan for its employees. On March 15, 1971 the Trustees of that plan signed a contract with Occidental whereby the Trustees agreed to forward all of Local 688 contributions in an agreed upon amount of Forty Dollars per week per active participant, to Occidental. Occidental agreed to pay benefits due under the plan. Under the plan monthly retirement benefits were calculated at Forty Dollars times years of credited service.

2. Kavner retired on January 1, 1972. Based upon a service date in exhibit B to the contract, he had thirty years of credited service, which entitled him to a pension of

Twelve Hundred Dollars per month. Occidental paid him this amount from January 1, 1972 through April, 1975 when he was cut off entirely. Saffo retired on August 3, 1973 with twenty years credited service, and began receiving a pension of Eight Hundred Dollars per month. Beginning in November of 1975 his pension was reduced to Two Hundred Ninety Six Dollars and Four Cents ($296.04) per month. Gibbons retired on August 1, 1973 and, based upon a service date on Exhibit B to the plan, he received Twelve Hundred Dollars per month. From May, 1975 through October, 1975 his check was reduced to Nine Hundred and Sixty Dollars ($960.00) per month. In November, 1975, his check was further reduced to Three Hundred Sixty One Dollars and Five Cents ($361.05) per month. The Trustees have made all payments due under their contracts with Occidental.

3. Local 688 employees were notified of the details of the plan. Each of the plaintiffs continued his employment in reliance upon his right to receive a monthly pension calculated at Forty Dollars times his years of credited service, and each of them retired in reliance on the same. The employees of 688, including the three plaintiffs, agreed to forego a salary increase in order to fund their pensions.

4. Occidental agreed to "provide and guarantee" the pensions of all persons listed on exhibit B to the plan, including these plaintiffs. This guarantee was effective the day the contract was signed. Occidental's representations to the Trustees were calculated to lead them to believe, and did cause them to believe, that the guarantee was effective the day the contract was signed.

5. The 688 pension plan, excluding Occidental's guarantee, has never been actuarially sound under the actuarial assumptions used by Occidental. There is just no reasonable likelihood that contributions for 688 participants at the rate of Forty Dollars per week per active participant will ever be sufficient to pay pensions for 688 retirees given the

actuarial assumptions used by Occidental. Under those assumptions on January 1, 1974 Occidental had incurred an actuarial liability of One Million Sixty Seven Thousand Dollars ($1,067,000.00) on its guarantee.

6. Because Occidental had guaranteed the pensions of Kavner and Gibbons, the Trustees' actions in cutting off Kavner's pension and reducing Gibbons' pension were of no benefit to any other plan participant. Occidental did not inform the Trustees of this fact.

7. Because of its guarantee and because it could not require increased contributions to pay exhibit B participants, Occidental was a risk taker and not a mere stakeholder. It took the risk of having to pay out more in pension than it received in contributions, and it stood to profit from high employee turnover by having the use of the pension fund for a longer period of time. Under its guarantee, proper actuarial practice required Occidental to maintain separate accounts for exhibit B and non-exhibit B participants, and to show its valuations on these accounts separately in its actuarial reports.

8. Because they could be removed by the union's officers, without cause, from their positions as Trustees, and because they were union employees who could be fired without cause, the Court finds that the Trustees were under the domination and control of the union and that their acts were the acts of the union.

9. The Court finds that it was not reasonable for the Trustees to believe that certain language in a letter from the district director of the Internal Revenue Service "required" them, in order to maintain the plan's qualification, to reduce benefits in an amount sufficient to make a plan be actuarially sound. However, even if the Trustees had believed that this letter required them to raise contributions there were several alternatives that should have been pursued. For example, it was not reasonable for them to divest

plaintiffs of their pensions without appealing such an order within the IRS. It was not reasonable for them to divest plaintiffs of their pensions without first seeking to require the union to make sufficient contributions to pay the pensions in accordance with its agreement. It was unreasonable for the Trustees to reduce benefits retroactively, rather than prospectively only, without first attempting to demonstrate to the IRS that a reduction which was prospective only was justifiable as a "business necessity". Finally, the Trustees acted unreasonably because an unknown portion of the reduction in benefits was attributable to changes in the plan which were not required by the IRS.

10. When Kavner was assigned to the International Union in 1958 he was given a "leave of absence" from Local 688 by Gibbons, the executive head of the Local, who had such authority. While Kavner was on assignment to the International he performed substantial services for Local 688. Also, his service to the International was of value to Local 688. For these reasons he did not have a "break in service" from 1958 through 1963 as that term is used in plan B.

11. Kavner was not guilty of fraud in placing on his retirement application the number of years of credited service to which he was entitled under the terms of the contract. Nor was he guilty of fraud in negotiating with Occidental a service date which included the period during which he was on assignment to the International.

12. There was no indication that Trustee Goodwilling[1] acted with the approval of the other Trustees in eliminating Kavner's pension. Even if the majority of the Trustees did concur their action was arbitrary and capricious because they did so without a hearing.

---

[1] The Court did not credit Goodwilling's testimony.

13. In 1949 Gibbons was the chief executive officer of an independent union known as the Joint Counsel which he merged with Local 688. The combined union was also known as Local 688 but was under Gibbons' leadership. His service date on exhibit B includes credit for his years as head of the Joint Counsel. Where there is a merger of two unions, it is in the best interests of both unions that the resulting entity recognized the service credits of the employees of both of the merging unions.

14. Gibbons did not commit any fraud with regard to his service date on exhibit B or with regard to the years of credited service on his application for a pension.

15. In its actuarial reports to the Trustees, and in the valuation summary submitted to the IRS, Occidental showed its own liability of One Million Sixty-Seven Thousand Dollars ($1,067,000.00) on its guarantee as being part of plan B's unfunded actuarial liability. There is no evidence that Occidental ever informed either the Trustees or the IRS that its statement of plan B's unfunded actuarial liability included its own liability for the guarantee. Because they showed Occidental's liability as part of the fund's liability, the actuarial reports and valuation summary were misleading, deceptive and inaccurate. In submitting actuarial reports and a valuation summary which showed its own liability as a liability of the fund, Occidental failed to use that degree of skill and learning ordinarily used under the same or similar circumstances by actuaries.

16. The misleading valuations shown on the valuation summary submitted to the IRS caused the district director of the IRS to question the actuarial soundness of plan B. This in turn caused the adoption of Amendment 4 which divested plaintiffs of their pensions.

17. In preparing a proposal for the Trustees as to the amount of reduction in prospective benefits it would require as a condition of adding the additional features to the plan

which the Trustees desired, Occidental gave no credit for the amount by which its liability on the guarantee would have been reduced. Amendment 2, if it had gone into effect, would have substantially reduced Occidental's liability on its guarantee. Occidental withheld this information from the Trustees. The IRS then found that Amendment 2 would have constituted a "partial termination" of the plan, which would have disqualified it, because the actuarial value of the "improvements" was substantially less than the value of the cash benefits lost.

18. Amendment 4 reduced Occidental's liability to exhibit B participants by over Eight Hundred Thousand Dollars ($800,000), which fact Occidental did not tell the Trustees. In failing to disclose to the Trustees that Amendment 4 would reduce its own liability by over Eight Hundred Thousand Dollars ($800,000), Occidental failed to use that degree of skill and learning ordinarily used under the same or similar circumstances by actuaries. The submission to the Trustees of valuation summaries, which Occidental claimed showed the amount of reduction necessary to both fund the "improvements" in Amendment 4 and make plan B actuarily sound, without informing the Trustees that the amendment would reduce Occidental's liability by over Eight Hundred Thousand Dollars ($800,000), constituted a material misrepresentation. Occidental knew the representation to be false, and intended for the Trustees to act upon it. The Trustees were ignorant of the truth, and relied upon the misrepresentation to the injury of the beneficiaries.

19. In reducing its payments to Gibbons and Saffo, and stopping payments to Kavner, Occidental committed breaches of contract. In permitting the Trustees to change plaintiffs' payment Local 688 committed breaches of contract. In directing Occidental to change payments to plaintiffs the Trustees acted in violation of the plan and the trust agreement.

20. In failing to inform the IRS that it had guaranteed over One Million Dollars of what it showed as the unfunded actuarial liability of plan B, Occidental was guilty of actuarial malpractice and breach of its contract to provide actuarial services and reports. In failing to inform the Trustees that Amendment 4 would reduce its own liability by over Eight Hundred Thousand Dollars ($800,000), Occidental was guilty of fraud, malpractice, breach of fiduciary duty and breach of its contract to provide services and reports.

Conclusions of Law

The theories of liability in this action are based upon the pension plan and the duties held under it by Occidental and the Trustees. The plaintiffs, having relied upon the existence of the plan in several ways, are entitled to enforce it. Plaintiffs' rights were vested and could only have been changed in accordance with the term of the plan and various statutory requirements.

The plan provided an unusual feature. In return for receiving custody of the fund, Occidental guaranteed the possession payments of "exhibit B" employees beyond the contributions made on their behalf. Thus in determining the solvency or "actuarial soundness" of the fund, the guarantee had to be considered. It was not considered, in part because of Occidental's misrepresentations and in part because of the Trustees failure to perform their duties diligently. Local 688 must share the responsibility for the Trustees' breach of duty because it controlled them so closely.

The reductions based upon changes in service dates will not be discussed in detail. The evidence simply does not support the service dates suggested by the Trustees for either Kavner or Gibbons.

There may be circumstances where Trustees of a pension plan, acting to protect its tax exempt status, could reduce benefits. This is not such a case. The pressure exerted on Local 688 and the Trustees by the IRS was in large part due to misinformation. Further, the reaction to that pressure was not reasonable. Thus it must be concluded that defendants should have continued to pay plaintiffs' pensions at the rates used in 1972, 1973 and 1974.

The question of damages presents greater problems. Plaintiffs seek a lump sum representing the present value of their benefits. The Court is more inclined to order payment of back benefits due and declare the rights of the parties under the pension plan, ordering continued payments. In any event, the parties (through counsel) are ordered to meet within twenty (20) days of this date to attempt to agree upon a proper amount of damages. They should report their efforts to the Court. If agreement cannot be reached, further briefs limited to that issue should be filed within thirty (30) days of this date. Plaintiffs also seek attorneys' fees and punitive damages. The Court does not consider punitive damages appropriate. However, plaintiffs are awarded attorneys' fees pursuant to 29 U.S.C. § 1132(g). The parties are instructed to attempt to agree on an appropriate amount under the procedure stated above.

Dated this 29th day of June, 1978.

/s/ H. Kenneth Wangelin
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term, 1978

Nos. 78-1634 and 78-1638.

No. 78-1634.

CHARLES SAFFO, *et al*, *Appellees*,

vs.

LHI-688 EMPLOYEES RETIREMENT AND PENSION PLAN TRUST, et al, *Appellants*.

No. 78-1638.

CHARLES SAFFO, *et al*, *Appellees*,

vs.

OCCIDENTAL LIFE INSURANCE COMPANY OF CALIFORNIA, etc., *Appellants*.

Appeals from the United States District Court for the Eastern District of Missouri.

The Court having considered three separate petitions for rehearing en banc filed by counsel for appellant, Occidental Life Insurance Company; appellee, Richard Kavner; and appellee, Harold J. Gibbons and, being fully advised in the premises, it is ordered that the petitions for rehearing en banc be, and they are hereby, denied.

Considering the petitions for rehearing en banc as petitions for rehearing, it is ordered that the petitions for rehearing also be, and they are hereby, denied.

July 9, 1979

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term, 1978

Nos. 78-1634 and 78-1638

CHARLES SAFFO, et al., *Appellees*,

v.

OCCIDENTAL LIFE INSURANCE COMPANY OF CALIFORNIA, and LHI-688 EMPLOYEES RETIREMENT AND PENSION PLAN TRUST, et al., *Appellants*.

Appeals from the United States District Court for the Eastern District of Missouri.

Motion of Occidental Life Insurance Company of California, a corporation, appellant in Cause 78-1638, seeking recall of our previously issued mandate has been considered by the Court and is denied.

August 20, 1979.

APPENDIX B

Statutes

Internal Revenue Code of 1954

I.R.C. Section 401(a)(4), 26 U.S.C. § 401 (a)(4)

§ 401. Qualified pension, profit-sharing, and stock bonus plans

(a) Requirements for qualification

A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

* * *

(4) if the contributions or the benefits provided under the plan do not discriminate in favor of employees who are—

(A) officers,

(B) shareholders, or

(C) highly compensated.

For purposes of this paragraph, there shall be excluded from consideration employees described in section 410(b)(2)(A) and (C).

Employee Retirement Income Security Act of 1974

ERISA Section 3(21), 29 U.S.C. § 1002(21)

§ 1002. Definitions

For purposes of this subchapter:

* * *

(21)(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

(B) If any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.], such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this subchapter, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

ERISA Sections 502(d)(1) and (d)(2), 29 U.S.C. §§ 1132(d)(1) and (d)(2)

§ 1132. Civil enforcement

* * *

(d) Status of employee benefit plan as entity

(1) An employee benefit plan may sue or be sued under this subchapter as an entity. Service of summons, subpena or other legal process of a court upon a trustee or an administrator of an employee benefit plan in his capacity as such shall constitute service upon the employee benefit plan. In a case where a plan has not been designated in the summary plan description of the plan an individual as agent for the service of legal process, service upon the Secretary shall constitute such service. The Secretary, not later than 15 days after receipt of service under the preceding sentence, shall notify the administrator or any trustee of the plan of receipt of such service.

(2) Any money judgment under this subchapter against an employee benefit plan shall be enforceable only against the plan as an entity and shall not be enforceable against any other person unless liability against such person is established in his individual capacity under this subchapter.

ERISA Sections 514(a), (b) and (c), 29 U.S.C. §§ 1144(a), (b) and (c)

§ 1144. Other laws

(a) Supersedure; effective date

Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

(b) Construction and application

(1) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975.

(2)(A) Except as provided in subparagraph (B), nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking or securities.

(B) Neither an employee benefit plan described in section 1003(a) of this title, which is not exempt under section 1003(b) of this title (other than a plan established primarily for the purpose of providing death benefiits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(3) Nothing in this section shall be construed to prohibit use by the Secretary of services or facilities of a State agency as permitted under section 1136 of this title.

(4) Subsection (a) of this section shall not apply to any generally applicable criminal law of a State.

(c) Definitions

For purposes of this section:

(1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State. A law of the United States applicable only to the District of Columbia shall be treated as a State law rather than a law of the United States.

(2) The term "State" includes a State, any political subdivisions thereof, or any agency or instrumentality

of either, which purports to regulate, directly or indirectly, the terms and conditions of employee benefit plans covered by this subchapter.

Treasury Regulations

Section 1.412(c)(2)-1 (proposed)

§ 1.412(c)(2)-1 Valuation of plan assets; reasonable actuarial valuation methods.

(a) *Introduction*—(1) *In general.* This section prescribes rules for valuing plan assets under an actuarial valuation method which satisfies the requirements of section 412(c)(2)(A).

(2) *Exception for certain bonds, etc.* The rules of this section do not apply to bonds or other evidences of indebtedness for which the election described in section 412(c)(2)(B) has been made, nor are such assets counted in applying paragraphs (b) or (c) of this section.

(3) *Defined benefit plan.* See paragraph (b) of this section.

(4) *Defined contribution plan.* To satisfy the requirements of section 412(c)(2)(A), a defined contribution plan must value assets solely on the basis of their fair market value (under paragraph (c) of this section).

(b) *Defined benefit plans*—(1) *In general.* To satisfy the requirements of section 412(c)(2)(A), an actuarial method of valuing assets of a defined benefit plan must meet the requirements of this paragraph (b).

(2) *Purpose.* (i) In general, the purpose of this paragraph (b) is to permit use of reasonable actuarial valuation methods designed to mitigate shortrun changes in the fair market value of plan assets.

(ii) The funding of plan benefits and the charges and credits to the funding standard account required

by section 412 are generally based upon the assumption that the defined benefit plan will be continued by the employer. Thus, shortrun changes in the value of plan assets presumably will offset one another in the long term. Accordingly, in the determination of the amount required to be contributed under section 412 it is generally not necessary to recognize fully each change in fair market value of the assets in the period in which it occurs.

(iii) The asset valuation rules contained in this paragraph (b) permit a "smoothing" effect. Thus, investment performance, including appreciation or depreciation in the market value of the assets occurring in each plan year may be recognized gradually over several plan years. This "smoothing" effect is in addition to the "smoothing" effect which results from amortizing experience losses and gains over 15 or 20 years under section 412(b)(2)(B)(iv) and (3)(B)(ii).

(3) *Consistent basis.* (i) The actuarial asset valuation method must be applied on a consistent basis. Any change in meeting the requirements of this paragraph (b) is a change in funding method subject to section 412(c)(5).

(ii) A method may satisfy the consistency requirement even though computations are based only on the period elapsed since the adoption of the method or on asset values occurring during that period.

(4) *Statement of plan's method.* (i) The method of determining the actuarial value (but not fair market value) of the assets must be specified in the plan's actuarial report (required under section 6059) both for the first plan year such method is employed and for any subsequent plan year for which the method is modified. The method must be described in sufficient detail so that another actuary employing the method described would arrive at a reasonably similar result.

(ii) Any deviation from the described method is a change in funding method subject to section 412(c)(5), even if the deviation is made with respect to a new type or class of plan assets not previously held by the plan or is made because of an erroneous or incomplete description of the method.

(5) *Consistent valuation dates.* The same day (such as the first or the last day of a plan year) must be used for all purposes to value the plan's assets for each plan year for which a valuation is made. A change in the date used is a change in funding method.

(6) *Reflect fair market value.* The valuation method must make use of the fair market value (determined under paragraph (c) of this section) of the plan's assets as of the applicable asset valuation date, either in the direct computation of their actuarial value or in the computation of both maximum and minimum limits of such value. A method will not satisfy the requirement of the preceding sentence if it is designed to produce a result which will be significantly and consistently above or below fair market value.

(7) *80-120 corridor.* The method must result in an actuarial value of the plan's assets which is not less than 80 percent nor more than 120 percent of their current fair market value as of the applicable asset valuation date.

(8) *Examples.* This paragraph (b) may be illustrated by the following examples. In each example, assume that the pension plan uses a consistent actuarial method of valuing its assets.

Example 1. Plan A considers the value of its assets to be initial cost, increased by an assumed rate of growth of 4 percent annually. However, the method requires that the actuarial value be within an 80-120 percent corridor, i.e., that the result not be more than 120

percent nor less than 80 percent of the current fair market value as of the valuation date. Assuming that the 4 percent factor used by the plan is a reasonable assumption, this method is not designed to produce results consistently above or below fair market value. Since the method properly reflects fair market value and is within the required 80-120 corridor, it is permitted.

Example 2. Plan B considers the actuarial value of its assets to be their fair market value. However, if necessary an adjustment is made to make the actuarial value fall within a "5 percent" corridor. This corridor is plus or minus 5 percent of the following amount; the fair market value of the assets at the beginning of the valuation period plus an assumed annual growth of 4 percent and adjusted for contributions and benefit payments during the period. Assuming that the 4 percent factor used by the plan is a reasonable assumption, this method is not designed to produce results consistently above or below fair market value. However, this method is unacceptable because in some instances it may result in values outside the 80-120 corridor. This method would be permitted if a second corridor were imposed which would prevent the value of the total plan assets from falling outside of the 80-120 percent corridor.

Example 3. Plan C values it assets by multiplying their fair market value by an index number. The use of the index results in the hypothetical average value that plan assets present on the valuation date would have had it [sic] they had been held during the current and four preceding years, and had appreciated or depreciated at the actual yield rates including appreciation and depreciation experienced by the plan during that period. However, the method requires an adjustment, if necessary, to bring the resulting actuarial value of

the assets inside the 80-120 corridor. This method is permitted.

Example 4. Plan D values its assets by multiplying their fair market value by 90 percent. Although the results of this method will always be within the required corridor, it is not acceptable because it will consistently and significantly result in a value less than fair market value.

(c) *Fair market value of assets*—(1) *In general.* Except as otherwise provided in this paragraph (c), the fair market value of a plan's assets for purposes of this section is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge or [sic] relevant facts. The valuation principles in the regulations under section 2031 apply.

(2) *Insurance agreements.* (i) Agreements with an insurer (including agreements between the employer or plan trustee and an insurer) involving the payment of benefits under the plan shall be valued in accordance with paragraph (c)(3) or (c)(4) of this section, whichever is applicable.

(ii) For purposes of this paragraph (c), the term "insurer" means a company or association authorized to do business under a State law regulating insurance companies.

(3) *Insurance agreements; allocated portion of agreement.* (i) If an insurer has a legally enforceable obligation to provide plan benefits to specific plan participants or their beneficiaries, the plan must on a consistent basis apply one of the methods described in this paragraph (c)(3) to value the obligation. An insurer has a legally inforceable [sic] obligation to pay benefits if the insurer is obligated to provide such benefits with-

out further obligation by the plan to pay any consideration for the benefits.

(ii) The plan may exclude the obligation's fair market value from the fair market value of plan assets. If this method is used, the plan must also exclude the value of such benefits from the computation of the plan's liability to pay benefits.

(iii) The plan may include in the fair market value of its assets the present value of the plan benefits which as of the valuation date are a legally enforceable obligation of the insurer and which are included in the computation of the plan's liability to pay benefits.

(iv) The plan may include in the fair market value of its assets the obligation's cancellation value. For purposes of this paragraph (c), the term "cancellation value" means the sum of funds which would be received by the plan if the agreement were terminated on the valuation date. Any payment to be made to the plan more than one year after the termination of the agreement must be taken into account at its present value. Cancellation value includes the present value of benefits which will continue to be guaranteed by the insurer, unless they are excluded from the computation of the plan's liability to pay benefits. To the extent that the plan, on termination of the agreement, may receive either funds or benefits continued to be guaranteed by the insurer, the cancellation value shall include the greater of the two amounts.

(4) *Insurance agreements; unallocated portion of agreement.* (i) If an insurer maintains a fund on behalf of the plan, and provides plan benefits from the fund either by direct payment from the fund or by the purchase of annuity contracts, then the plan must apply the method described in paragraph (c)(4)(ii) of this section in valuing the fund. The plan must

apply this method on a consistent basis whether or not the assets of the plan contributed to the fund are commingled with other assets held by the insurer.

(ii) The plan must include in the fair market value of its assets the fund's account balance computed pursuant to the agreement providing for the fund, whether or not the insurer maintains its own separate records based upon experience. However, this account balance shall not include any amount that the insurer is entitled to withdraw from the fund as consideration for an obligation to pay plan benefits. The amount which may be withdrawn is to be determined at the valuation date. See paragraph (c)(3) of this section for a description of an insurer's obligation to pay benefits.

(5) *Plan termination insurance.* For purposes of this section, plan termination insurance for which premiums are paid from plan funds pursuant to section 4006 of the Employee Retirement Income Security Act of 1974 is not a plan asset.

(d) *Effective date and transition rules*—(1) *Effective date.* This section applies to plan years to which section 412, or section 302 of the Employee Retirement Income Security Act of 1974 applies.

(2) *Special rule for certain plan years.* For plan years beginning prior to [the date this regulation is published in the FEDERAL REGISTER as a final regulation], the amounts required to be determined under section 412 may be computed on the basis of any reasonable actuarial method of asset valuation which takes into account the fair market value of the plans assets, even if the method does not meet the requirements of paragraphs (a) through (c) of this section.

(3) *Plan years beginning on or after [the date described in paragraph (d)(2) of this section].* Paragraphs (a) through (c) of this section apply beginning

with the first valuation of plan assets made for a plan year to which section 412 applies that begins on or after [the date described in paragraph (d)(2) of this section]. The statement of the plan's actuarial asset valuation method required by paragraph (b)(4) of this section must be included with the plan's actuarial report for that year, in addition to any subsequent years specified in that paragraph.

(4) *Effect of change of asset valuation method.* A plan which is required to change its asset valuation method to comply with paragraphs (a) through (c) of this section must make the change when those rules first become applicable to the plan. A method of adjustment must be used to take account of any difference in the actuarial value of the plan's assets based on the old and new valuation methods. The plan may use either:

(i) A method of adjustment described in paragraph (d)(5) or (d)(6) of this section without prior approval by the Commissioner, or

(ii) Any other method of adjustment if the Commissioner gives prior approval under section 412 (c)(5).

(5) *Retroactive recomputation method.* (i) Under this method of adjustment, the plan recomputes the balance of the funding standard account as of the beginning of the first plan year for which it must use its new asset valuation method. This recomputation is made as if the plan's new method applied as of the first day of the first plan year to which section 412 applies.

(ii) Beginning with the first plan year for which its new method must apply, the normal cost and amortization charges and credits to the funding standard account are computed as if its new method applied as

of the first day of the first plan year to which section 412 applies.

(iii) If the recomputed aggregate charges exceed the recomputed aggregate credits to the funding standard account as of the end of the first plan year to which its new method applies, an additional contribution to the plan may be necessary to avoid an accumulated funding deficiency in that year.

(6) *Prospective gain or loss adjustment method.* (i) Under this method of adjustment the plan values its assets under its new method on the first valuation date following [the date described in paragraph (d)(2) of this section].

(ii) If the plan uses a spread gain type funding method, the difference in the value of the assets under the two asset valuation methods is not separately amortized. Under a spread gain type of funding method, gains and losses are spread over future periods as a part of normal cost. Examples of this type of funding method are the aggregate cost method, frozen initial liability cost method, and the attained age normal cost method.

(iii) If the plan uses an immediate gain type of funding method the plan determines the difference in the value of the plan's assets based upon the old and new asset valuation methods. This difference is determined as of the first valuation date following [the date described in paragraph (d)(2) of this section]. Under an immediate gain type of funding method, gains and losses are separately recognized and amortized over a fixed number of years. Examples of this type of funding method are the unit credit method, the entry age normal cost method, and the individual level premium cost method.

(iv) The difference determined under paragraph (d)(6)(iii) of this section may be treated as arising from an experience loss or gain, and this amortized under section 412(b)(2)(B)(iv) or (3)(B)(ii); or alternatively it may be treated as arising from a change in actuarial assumptions, and this amortized under section 412(b)(2)(B) or (3)(B)(iii).

JEROME KURTZ,

Commissioner of Internal Revenue.

43 Fed. Reg. 38027 (1978)